

DIARY

Book 23

May 1 - May 10, 1936

	Book	Page
American Red Cross		
Memorandum from General Counsel as to whether Secretary of Treasury can resign from Board of Trustees - 5/15/36.....	XXIII	80-84
Appointments and Resignations		
Max O'Rell Truitt considered as successor to Robert L. Jackson - 5/4/36.....		36-38
a) FDR endorses		
b) Oliphant report		
c) Jerome Frank's recommendation		
Associated Gas and Electric Company		
Resume' 5/5/36 to 2/10/37.....		73-79

Byrd, Harry F. (Senator, Virginia)
See Revenue Act, 1936

Canada		
Further conference with representatives of Canadian distillers - 4/30/36 (Graves memorandum).....		6-8
Further conference with representatives of Canadian distillers - 5/4/36 (Graves memorandum).....		25-27
Further conference - 5/6/36 (Graves memorandum).....		117-119
China		
See HMJr - Chinese delegation conversations, Book LXXVIII, page 190		
See also Silver		
Conference: Chen and Koo, Taylor, Lochhead, and White - 4/28/36 (Taylor memorandum).....		1-3
Viner memorandum concerning present negotiations.....		21
Taylor memorandum calling attention to certain points in memoranda submitted by Chinese representatives - 5/6/36..		112-114
Civilian Conservation Corps		
See Financing, Government		
Draft of HMJr memorandum to FDR as to difficulties of securing full enrollment (not sent).....		182-184
Corporations		
Thomas L. McGarter (President, Public Service Corporation of New Jersey) sees HMJr concerning simplification of corporate structures without risk of unbearable and unknown tax liabilities - 5/5/36.....		32-34
Countervailing Duties		
Sayre (State Department) sends to Golden W. Bell (Assistant Solicitor General) memorandum concerning, stressing injury to United States trade - 5/4/36.....		40-43

	Book	Page
Crowley, Leo T.		
Wheeler (Burton K.) letters to O'Connor and Jones - 5/5/36.....	XXIII	85-90
HMJr memorandum to O'Connor, reminding him that, on 3/22/35, he asked that case be settled - 5/5/36.....		91
(Copies of note and telephone conversation 3/22/35, pages 105-107)		
a) O'Connor reply.....		92-98
b) HMJr's reply to O'Connor.....		108
c) HMJr tells McIntyre of his note to O'Connor.....		99
HMJr, O'Connor, and McReynolds confer - 5/5/36.....		100-104
HMJr, Jones, O'Connor, and McIntyre to confer; HMJr asks Crowley to hold himself in readiness for call to White House - 5/6/36.....		129 A-C
HMJr tells "Tim" Fox to stay out - 5/6/36.....		129 D-E

- F -

Financing, Government

HMJr and Bell confer with Tugwell and Baldwin (Resettlement Administration) - 5/4/36.....		44-57
HMJr and Bell confer with Hopkins - 5/5/36.....		58-59
a) Estimated funds needed by Works Progress Administration, assuming that present financial procedure is not revised.....		60
b) Estimated funds needed by Works Progress Administration, assuming that present financial procedure <u>is</u> revised....		61
c) Works Progress Administration employment program.....		62
d) Works Progress Administration funds as of 4/20/36.....		63
e) Obligations and expenditures.....		64
f) Estimated cost for May, 1936.....		65
g) Status of funds allocated to specified agencies 4/20/36.		66
HMJr tells FDR if all the \$48 million assigned to Tugwell for purchase of land is not obligated, balance should be cancelled; FDR agrees - 5/5/36.....		67
HMJr suggests to FDR that unexpended balance by Civilian Conservation Corps be turned over to Hopkins - 5/7/36.....		130
FDR asks that Bell report on all unexpended balances.....		130
Hopkins and Bell confer again with Hopkins - 5/8/36.....		131
a) HMJr does not want any of \$1.5 billion obligated or spent before July 1		
b) Bell works out unexpended balances.....		132,133
c) FDR authorizes transfer of 5% of unexpended balances to Works Progress Administration - 5/7/36.....		134-135

- G -

Germany

Sayre (State Department) sends to Golden W. Bell (Assistant Solicitor General) memorandum concerning countervailing duties, stressing injury to United States trade - 5/4/36...	40-43
---	-------

	Book	Page
Housing		
Conference: HMJr, Jones and Alley of Reconstruction Finance Corporation, Bell and Oppen - 5/8/36.....	XXIII	193-197
a) Wagner bill resume'		198

Liquor
See Canada

May, George O. (Senior Partner - Price, Waterhouse, and Company)		
Challenges Treasury estimates - See Revenue Act, 1936.....		151-161, 168-171, 174-176, 186 A-J
McCarter, Thomas L. (President, Public Service Corporation of New Jersey)		
See Corporations (simplification of structure).....		32-34
Mexico		
Viner memorandum concerning negotiations - 5/2/36.....		31
Suarez proposal concerning use of silver inside Mexico discussed by HMJr and Mexican Ambassador - 5/7/36.....		137-139
a) Suarez memorandum.....		141-147

New Orleans, Louisiana		
Index of cases - 5/9/36 to 8/11/36.....		200-208

O'Connor, J. F. T. (Comptroller of Currency)		
See also Crowley, Leo T.		
Memorandum to HMJr concerning violation of rule that all bills should be cleared through Director of Budget - 5/6/36.....		120-122
a) Taylor memoranda attached		
b) Memorandum on bill in question "to provide a national currency by pledge of United States bonds and to provide for circulation and redemption thereof"		123-124, 126-127
Wall Street Journal 5/6/36: "O'Connor's bank bills opposed by Federal Deposit Insurance Corporation"		128-129

Price, Waterhouse, and Company
For George O. May criticism of Treasury estimates,
see Revenue Act, 1936

Radio Addresses by HMJr

HMJr considers one for Sunday night 6/14/36: "50 weeks of the 52-week fiscal year have passed, " et cetera - 5/4/36.....	XXIII	39
Relief, Unemployment		
See Financing, Government		
Resettlement Administration		
Tugwell and Baldwin confer with HMJr and Bell - 5/4/36...		44-57
Revenue Act, 1936		
HMJr asks concerning proposed tax on undistributed earnings - is it fair to small business man? - 5/1/36..		5
a) Oliphant's answer.....		13-19
b) Viner's answer.....		20
Haas testimony before Senate Committee - 5/1/36.....		9
New York Times: "Senators move to increase tax bill yield \$190 million after Morgenthau plea" - 5/1/36.....		10-12
HMJr asks concerning loopholes - 5/4/36.....		22
a) Oliphant's memorandum.....		70 C
HMJr and Upham join conference in Harrison's office at 5 P.M. 5/7/36.....		148-150
George May challenges part of Treasury estimates		
a) Drafts of HMJr's letter to Harrison, concerning....		151-155
b) Press conference.....		156-161
c) HMJr discusses with Upham, Haas, Bell, Taylor, Gaston, and Oliphant.....		168-171
1. HMJr wants to invite outstanding economist to check estimates		
2. Taylor suggests alternate plan (see pages 172-173)		
d) New York Times article concerning HMJr-May correspondence 5/8/36.....		174-176
e) HMJr discusses article with Earle Bailie - 5/8/36....		186 A-J
Senator King requests estimates of yield of certain tax proposals.....		162-165
Senator Byrd (Harry F.) addresses letter to HMJr, concerning certain financially strong corporations "which will pay little or no tax if pending bill is passed" - 5/8/36....		166-167
HMJr tells FDR, Pat Harrison wants to see him (FDR); HMJr thinks Treasury should have dress rehearsal first - 5/8/36.....		185

Silver

See also China		
Senate Resoluticn introduced by Senator King, inviting Governments of America, including Canada, to attend conference to increase use of silver - 4/24/36.....		70 F

	Book	Page
Stabilization (arranged chronologically)		
HMJr talks with Cochran - 5/1/36.....	XXIII	4-4 E, 28
a) Franc is weak		
b) British Stabilization Fund deals directly with the French banks		
c) British will do all possible to keep French from devaluing		
d) Cochran will see Schacht over week-end		
HMJr talks to Cochran - 5/4/36.....		43 A-E
a) Could not see Schacht (still in Berlin)		
HMJr talks to Cochran - 5/5/36.....		68 A-E
a) Situation worse; British Control is intervening		
Knoke's telephone conversation with Bank of France - fairly quiet in France - 5/5/36.....		69
HMJr and Bewley dine with Taylor - 5/5/36.....		70
a) Bewley embarrassed at not having received reply from England for HMJr		
b) HMJr again indicates advantage of opening channel to exchange information		
c) Tells FDR of talk		
Knoke's conversation with Bolton of Bank of England asking whether United States Treasury would purchase gold at \$35.00 for shipment to New York - 5/5/36....		72
a) Lochhead's conversation with HMJr, concerning..		72 B-C
Knoke tells Bolton United States Treasury will not pay price for gold abroad which, with shipping charges added, brings cost of delivery in New York above \$35.00 per ounce - 5/6/36.....		115-115 A
Cabinet (French) members will remain until June 1 - so Cochran tells HMJr; has quieting effect - 5/6/36.....		116-116 D
FDR and HMJr confer - 5/7/36.....		136
a) "England looking which way to turn in case France goes off gold"		
Bankers Trust Company, London, cable concerning inclusion of Bank of England by Secretary of Treasury for gold shipments - 5/5/36.....		136 B
Knoke-Bolton (Bank of England) conversation 5/8/36.....		181
a) Paris conditions not so bad as day before - almost panic then		
b) Distinct weakening in position of Dutch and Swiss		

- T -

Taxation

See Revenue Act, 1936

Truitt, Max O'Rell

See Appointments and Resignations

- W -

Works Progress Administration

See Financing, Government

TREASURY DEPARTMENT

1

INTER OFFICE COMMUNICATION

DATE May 1, 1936.

TO Secretary Morgenthau

FROM Mr. Taylor

Subject: Substance of conference of the Chinese representatives -
Mr. Chen and Mr. Koo - with Treasury representatives -
Mr. Taylor, Mr. Lochhead, and Mr. White - 3:00 P. M.,
April 28, 1936.

1. Industrial use of silver.

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

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

2. Silver coins.

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

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

3. Silver reserves.

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

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

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

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

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

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

It was pointed out that this would have the effect of greatly reducing the strength of the reserves inasmuch as the new coins contain much less silver than the old coins. The view was also expressed that such a modification might reduce confidence

Secretary Morgenthau - 5/1/36, 3.

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

4. Yuan-dollar-sterling exchange rate.

Mr. Koo described in some detail the exchange operations as they had been relayed to him in a cable just received. The altering of the dollar rate, he explained, was a consequence of the adoption of a policy designed to prevent the impression that the yuan was depreciating, and that the currencies happened to have moved in a way necessitating alteration of the official dollar rate in order to avoid that impression. He stated that it was the policy of the Bank to peg its currency to the one which was appreciating, and that had sterling dropped below \$4.88 the dollar rate would have been kept unchanged and the sterling rate altered in Shanghai.

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

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

4

Friday
May 1, 1936

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

HMjr: Well, what's new today?

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

HMjr: Yes

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

HMjr: I don't get that.

C: People are selling francs directly through the control.

HMjr: Now, say that again.

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

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

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

HMjr: Yes

C: - through the control.

HMjr: Yes

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

HMjr: Now, say that again, please.

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

HMjr: Over-trading?

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

HMjr: What kind of trading?

C: There is very little --

HMjr: Very little trading?

C: It is all being done in London.

HMjr: In London?

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

HMjr: I see.

C: The people here are buying dollars to some extent.

HMjr: They are doing what?

C: - are buying some dollars -

HMjr: Yes

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

HMjr: Your neighbor?

C: The Guaranty -

HMjr: Oh, yes

C: But most of the franc is in the sterling.

HMjr: In the sterling?

C: Yes

HMjr: Yes

C: And so the pressure is rather strong today.

HMjr: There's a what?

C: The pressure -

HMjr: Yes

C: The pressure on the franc is bad.

HMjr: I don't get that.

C: I say, the franc is weak.

HMjr: The franc is weak?

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

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

C: Well, the franc is weak, that I said.

HMjr: The what?

C: There are many people who want to sell their francs.

HMjr: Yes

C: So it is weak as a result.

HMjr: I don't get that.

C: Well, you do have it that they want to sell their francs?

HMjr: Yes

C: Well, that's the point.

HMjr: I see, all right.

C: They are afraid.

HMjr: I see. Now, - anything new on the political situation?

C: No, there is a lot of horse-trading back and forth, you see?

HMjr: Yes

C: But they don't know how complete discipline the Front Populaires will find on Sunday. But it still looks to me as if they will round a big majority.

HMjr: They'll do what?

C: That the Left - that the Left party -

HMjr: Yes

C: - will have a majority on Sunday.

HMjr: I see - and that means the present government will fall?

C: Well - oh fairly good, I think.

HMjr: What?

C: Fairly large - but it's still difficult to tell.

HMjr: And it still looks like Reynaud?

C: That's the proposition put up by those young men, you know -

HMjr: I get you.

C: But there is no public discussion on that whatever.

HMjr: Yes

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

HMjr: I get you.

C: If the situation gets bad enough.

HMjr: Yes

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

HMjr: Yes

C: The present man would try to patch up the

HMjr: Yes

C:

HMjr: All right - Your cables yesterday were very good.

C: Beg your pardon?

HMjr: Your cables yesterday were very good.

C: All right, fine.

HMjr: All right

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

HMjr: Yes

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

HMjr: All right

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

HMjr: All right.

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

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

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

HMjr: Oh -

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

HMjr: Yes

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

HMjr: Yes

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

HMjr: Oh, you could?

C: Yes

HMjr: Just be away Sunday?

C: Just be away Sunday.

HMjr: I think that would be a good idea.

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

HMjr: I think that would be very good.

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

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

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

HMjr: Yes, yes -

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

HMjr: Yes

C: I'll go down.

HMjr: O. K.

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

HMjr: That's right.

C: Takes place.

HMjr: All right, thank you.

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

HMjr: That's right.

C:

HMjr: Thank you

C:

HMjr: Goodbye.

C: Goodbye.

May 1, 1938

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

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

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

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

See Page 2 -



TREASURY DEPARTMENT

WASHINGTON

May 1, 1936.

U4

MEMORANDUM FOR THE SECRETARY:

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

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

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

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

United Distillers.

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

Seagrams.

Mr. Phillips, representing Seagrams, made no proposals or suggestions whatsoever. Although he had requested, and had been granted,

No dinner. A trip to Seagram's distillery at Relay, Md., where the guests were furnished food, all the drinks they cared to consume and a quart to take with them as a souvenir.

more than a week's time to enable him to consult with "interested parties," with a view to making a specific proposal to submit his company to the jurisdiction of our courts and secure judgment, he stated at yesterday's conference that he could make no such proposal. He simply repeated requests which he had made at last week's conferences for information as to the amount and character of security which the Government would consider acceptable. He was informed, as before, that the Government would expect him to take the initiative in this respect. You will recall that at last week's conferences Mr. Phillips made an offer in compromise of \$500,000, which was promptly rejected. He at that time indicated that this was the maximum amount which he was prepared to offer in settlement of the Government's claim, and that, in view of the rejection of this offer, his further suggestions would be limited to the second alternative (submission to jurisdiction and securing judgment). At the earlier conferences, there was protracted discussion between Mr. Phillips and the Government's conferees with respect to this second alternative. The Government's conferees made it clear to Mr. Phillips that the Government's position with reference to security was fairly represented by the pending legislation (as revised in conferences between the State and Treasury Departments), but that the Government would be prepared to receive and consider any alternative proposal which Mr. Phillips might care to make. In view of this, it was confidently expected that Mr. Phillips would submit specific proposals at yesterday's conferences, but, as has been said, he made none.

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

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

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

Consolidated Distillers.

*Secretary to Senators
and Congressmen*

Mr. Forsythe, representing Consolidated Distillers, submitted to the Government's conferees the current financial statements of his company, with a view to demonstrating that it was in no financial position

to make either a substantial offer in compromise of the Government's claim, or any proposal to secure payment of judgment. In the end, he suggested that he would be willing to make settlement on the same basis that was followed in the settlement of the Reifel case last August. This would mean a settlement, as he said, in the neighborhood of \$125,000. The Government's conferees pointed out that the circumstances surrounding the Reifel settlement were peculiar to that case, and that the Reifel case could not be taken as a precedent for the settlement of claims against other companies. Mr. Forsythe agreed to consider the matter further, and to advise on Monday, May 4, whether he could make further proposals on behalf of his company.

Hiram Walker.

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

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

OBSERVATIONS.

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

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

GRAVES.

[UNREVISED PRINT]

9

REVENUE ACT, 1936

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

SEVENTY-FOURTH CONGRESS

SECOND SESSION

ON

H. R. 12395

AN ACT TO PROVIDE REVENUE, EQUALIZE TAXATION
AND FOR OTHER PURPOSES

PART 2

MAY 1, 1936

M. W. W.

Printed for the use of the Committee on Finance



UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1936

1112

UNREVISED PRINT
REVENUE ACT, 1938

HEARINGS

COMMITTEE ON FINANCE
UNITED STATES SENATE

COMMITTEE ON FINANCE

PAT HARRISON, Mississippi, Chairman

WILLIAM H. KING, Utah
WALTER F. GEORGE, Georgia
DAVID I. WALSH, Massachusetts
ALBEN W. BARKLEY, Kentucky
TOM CONNALLY, Texas
THOMAS P. GORE, Oklahoma
EDWARD P. COSTIGAN, Colorado
JOSIAH W. BAILEY, North Carolina
BENNETT CHAMP CLARK, Missouri
HARRY FLOOD BYRD, Virginia
AUGUSTINE LONERGAN, Connecticut
HUGO L. BLACK, Alabama
PETER G. GERRY, Rhode Island
JOSEPH F. GUFFEY, Pennsylvania

JAMES COUZENS, Michigan
HENRY W. KEYES, New Hampshire
ROBERT M. LA FOLLETTE, Jr., Wisconsin
JESSE H. METCALF, Rhode Island
DANIEL O. HASTINGS, Delaware
ARTHUR CAPPER, Kansas

FELTON M. JOHNSTON, Clerk

ii

CONTENTS

Statement of—	Page.
Edmonds, Franklin Spencer, Philadelphia, Pa., representing the Philadelphia Chamber of Commerce.....	61
Fulbright, R. C., representing the Southern Pine Association.....	131
Haas, George C., Director of Research and Statistics, Treasury Department.....	29
Klein, Joseph J., New York City, chairman, committee on Federal legislation, the American Society of Certified Public Accountants.....	83
Lane, E. H., the Lane Co., Inc., Altavista, Va.....	112
Seidman, M. L., New York City, chairman, taxation committee, New York Board of Trade, Inc.....	79
Wilson, Paul H., Worcester, Mass., representing the Graton & Knight Co.....	123

iii

REVENUE ACT, 1936

FRIDAY, MAY 1, 1936

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

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

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

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

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

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

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

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

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

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

Mr. HAAS. The great bulk of them fit within my definition. Now, a corporation of that sort that has listed assets, or has assets listed at a certain valuation which total up large, does not mean that if the income continues low those assets will have to be written down so they become a small corporation, regardless of the fact they may own half a county, if they are in a real-estate business, in a livestock business, say. In other words, in the final analysis, from an economic

sense, the size of the corporation over any period is its income, its present income, and its anticipated future income. That is the basis for all valuations.

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

Mr. HAAS. That is right.

Senator KING. What category would you place those in?

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

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

I have already pointed out that under the proposed law small corporations would have a substantial advantage over large ones in the direct reinvestment of earnings. They would similarly enjoy two advantages in the process of growing through resubscribed earnings. In the first place, the very compactness of a small corporation permits this process to be carried on with a directness and informality which is impossible for the larger corporations. If under the present law small corporations retain their earnings through the consent and agreement of their stockholders, under the proposed plan, stockholders would be every bit as likely to use the proceeds of their dividend checks from the corporation to reinvest in additional stock. The whole operation of declaring out the year's profit as dividends and resubscribing all or a portion of such dividends to additional shares of the corporation's stock, either pro rata or in such proportions as might be mutually agreeable to the shareholders, could be completed in the course of a short stockholders' meeting.

The other advantage which small corporations, in general, would have over large ones would be in the absolute amount of money which would be available to be resubscribed. It is a good general rule that the principal stockholders in small, struggling, and newly established corporations are men of much smaller total incomes than the principal stockholders in large, prosperous, and well-established corporations. If, therefore, such principal stockholders subscribe back to the corporation for additional shares all or part of their dividend receipts, less the income tax thereupon, the proportion of the gross dividend receipts subscribed back by them will be much greater in the case of the average small corporation than in the case of the average large one. The great importance of the difference which exists because of the differing individual income-tax rates upon different income classes can best be seen when it is noted that while dividends which fall in the bracket between \$10,000 and \$12,000 of stockholders' individual incomes will be reduced by only 11 percent, or less than the present corporation taxes, by reason of the individual income tax, the dividends which fall in the income bracket between \$100,000 and \$150,000 will be reduced by a 62 percent individual income tax. In other words, a greater proportion of the earnings of small corporations will be available for reinvestment,

when paid out to their stockholders, than of large corporation. I submit that this differential will give smaller corporations a chance to catch up upon their larger rivals which they never have had under any previous tax legislation.

I think I have made it clear that small corporations would be given special advantages as compared with large corporations under the proposed change in our corporation taxes. I now turn to the objection that has been raised that the proposed change would prevent larger, as well as smaller, corporations from obtaining sufficient capital for expansion, because the proposed schedules of taxes are graduated according to the percentage of corporate earnings withheld from stockholders for reinvestment in the business.

The first answer to this contention is that the schedules already allow, besides the very liberal deductions from taxable income for depreciations, depletion, bad debts and the like, the withholding by the corporation of 30 to 40 percent of each year's current earnings upon payment of taxes less than the amounts payable under the existing law. For medium-sized and larger corporations, moreover, free access to the organized capital markets offers abundant opportunities to all profitable corporations for such additional capital funds as they may require.

Senator KING. Are you quite certain about that? You take a mining company, the investment market is not, as a rule, open to it, because it is so much of a gamble.

Mr. HAAS. Where do they get their money, Senator?

Senator KING. They get it out of the people who want to invest in it.

Mr. HAAS. Those who are gullible enough to go into a risky enterprise.

Senator KING. Those who want to make the investment. They do not borrow it, they have to get it from their own assets.

Mr. HAAS. Because the industry is one that involves the higher type of risk. It is a little more difficult to market their stock, because you have to select those people who are willing to go into an enterprise of that sort. Their capital market is somewhat more limited than other types of business with less risk. I think that is the only difference.

Senator KING. I know of an organization that proposed to invest over \$100,000 for the sinking of a shaft in a mining company. It was a gamble. If they got the ore they would be repaid otherwise they would not be repaid. If they got the ore then they would have to pay an enormous dividend the first year, because if they got the ore it would be in bulk and it would be very profitable. So the threat of this bill has prevented the consummation of this plan. I merely call your attention to that form of investment which has done so much for the mining resources in the West, as well as the petroleum interests and the coal interests.

Mr. HAAS. I do not see what effect, Senator, this bill has on the decision which they might make. I see your point. You have to reach a certain type of capital market because you have a certain type of risk, but I will be glad to come back to that.

Senator HASTINGS. Before you leave that, just above, in that same paragraph you are quite certain of your figure when you say, "The

withholding by the corporation of 30 to 40 percent of each year's current earnings upon payment of taxes less than the amounts payable under the existing law."

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

Mr. McLEOD. That is correct.

Senator HASTINGS. All right.

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

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

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

Mr. HAAS. You mean listed on any exchange?

Senator HASTINGS. Yes.

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

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

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

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

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

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

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

Mr. HAAS. That is right.

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

Mr. HAAS. Shall I proceed?

The CHAIRMAN. Yes.

Mr. HAAS. During the period between 1921 and 1930, inclusive, the American Telephone & Telegraph Co. paid regular dividends at the rate of \$9 per share, the dividends aggregating about 854 millions during the 10 years. But, during this same 10-year period, the corporation offered rights to purchase additional securities to its stockholders in 1921, 1922, 1924, 1926, 1928, and 1930, and in the aggregate raised about 950 millions of capital from its stockholders through the sale of such additional securities to them, or about \$100,000,000 more than the aggregate dividends paid to them during the period.

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

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

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

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

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

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

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

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

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

Mr. HAAS. I think they have.

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

Mr. HAAS. I do not know offhand.

Senator BARKLEY. The report released by the A. T. & T. 3 or 4 days ago shows the earnings in 1935, I think, were the largest since 1930.

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

Mr. HAAS. That is fine.

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

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

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

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

Mr. HAAS. It may be objected that the issue of such rights is open only to extremely large corporations or that the practice of issuing them is infrequent. Neither of these objections is true. Using figures compiled by the Commercial and Financial Chronicle, the Bureau of Business Research of the University of Illinois estimated that more than 3,000,000,000 of capital was raised by corporations in 1929 through the offerings of securities to their stockholders. In discussing such stock offerings Dewing, in his Financial Policy of Corporations, a standard work on this subject, says [reading]:

They occurred almost as frequently in 1922 and 1923 as they did in 1925 and 1929.

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

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

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

Senator BARKLEY. Yes.

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

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

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

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

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

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

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

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

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

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

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

Mr. HAAS. Whether you can use it or not depends on what it is invested in.

Senator BAILEY. Wait one minute. Let us talk plainly about it. You can use it, and do use it, by spending it. The surplus does not remain in the corporation doing nothing.

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

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

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

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

Mr. HAAS. No.

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

Mr. HAAS. That is right.

Senator BARKLEY. If a corporation plowed its earnings back into the business always and the stockholders got no dividend, they might, after a while, lose interest in the stock unless the stock was very closely held within a few hands, like some companies that we know of which never pay out any dividends, because for different reasons they either plow it back into the business or set it aside as a surplus anyway, but if a corporation over a long period of years plowed all of its earnings back into business and paid out no dividends it might have a little difficulty selling that stock to the public—is that not right?

Mr. HAAS. That is right.

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

Mr. HAAS. That is right.

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

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

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

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

Mr. HAAS. That is right.

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

Mr. HAAS. That is right.

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

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

Mr. KENT. Section 102.

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

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

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

Senator BAILEY. The stockholder's equity is not magic?

Mr. HAAS. No.

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

Mr. HAAS. Yes.

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

Senator BAILEY. That is the magic.

Mr. HAAS. Suppose you are a stockholder and you look at an account, what is your equity in the concern? You look at the capital

account and the surplus account, the two of them together; suppose the bank just increased their capitalization the day before yesterday? That is the point I am trying to make.

Senator BAILEY. How do you increase capitalization?

Mr. HAAS. By declaring stock dividends to the stockholders.

Senator BAILEY. By issuing stockholders' certificates equal to the surplus?

Mr. HAAS. Yes.

Senator BAILEY. But that would be magic.

Mr. HAAS. No; I should say the situation stayed just the same. Some people, laymen, might think, "Well, it would be better to have a surplus in there."

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

Mr. HAAS. That is right.

Senator CONNALLY. Is not that the differentiation?

Mr. HAAS. That is the main differentiation.

Senator HASTINGS. Mr. Haas, I would like to know whether or not you made any estimate along the line of an illustration that I want to make. Take a \$2,000,000 corporation over a period of 10 years, and suppose it earned 10 percent of \$200,000 for 5 years, but paid none of it out to its stockholders, it would then have accumulated \$1,000,000, and it paid to the Government each year \$32,000 in taxes; now, suppose at the end of 5 years it increases its plant, whatever its business is, by using all of the million-dollar surplus, it will then have \$3,000,000 capital investment; isn't that true?

Mr. HAAS. What did they do with the surplus over the 5 years that they earned it?

Senator HASTINGS. They just kept it.

Mr. HAAS. Just kept it in cash?

Senator HASTINGS. Yes.

Mr. HAAS. You mean in liquid security that they could turn in to buy plant?

Senator HASTINGS. Yes. My figures may not be exactly correct. Suppose at the end of 5 years it spent the million dollars by purchasing new material, giving labor to a lot of people, or what not; it increased the value of its plant by \$3,000,000, and it continues to earn 10 percent, so its earnings have been increased, then, from \$200,000 to \$300,000; its taxes under the present rate will then increase from \$32,000 to \$48,000, an increase of \$16,000.

Mr. HAAS. Yes.

Senator HASTINGS. I was wondering whether, over a period of 10 years, the first 5 during which time they were accumulating this dividend and the next 5 when they were making dividends at the same rate, I was wondering, from the Government's point of view,

which would give the Government the most money, under the new plan or under the old plan.

I am not expecting you to answer that right off, because that is a more or less complicated question. I think it would be very helpful if you could take some such illustration as that and see just where we would land. Of course, I assume you would have to take into account the question whether the owners of that corporation were in the higher bracket or the lower bracket, which would, I suppose, make a difficult problem.

Mr. HAAS. Yes. I could put an illustration in the record along the lines that you have suggested. You have to make some assumptions with regard to stockholders.

Senator HASTINGS. I suppose that is true.

Mr. HAAS. You would have to make some assumption as to the period in which this took place. Shall we say 10 years previous to this date?

Senator HASTINGS. I am assuming a period of 10 years when the profits were just the same, 10 percent on the investment during the whole 10 years, the first 5 years 10 percent on 2 million and the next 5 years 10 percent on the increase, which would be a million, less the taxes that had been paid.

The CHAIRMAN. And following that question will you put in the record several examples?

Mr. HAAS. All right.

The CHAIRMAN. Are there any other questions?

Senator BARKLEY. In that connection, while you are off your manuscript, somebody has scattered a good deal of misinformation; a good deal of misinformation has been broadcast about this bill. I am getting a lot of letters complaining because it taxes existing surpluses that have been created over the past. Of course, it does not, and I do not know who started that story; but I would like it to be put into the record, and for the press to carry, that this bill does not touch at all existing surpluses that have been created in the past.

Mr. HAAS. That is right. The bill concerns itself only with current earnings.

Senator LA FOLLETTE. On the other hand, Senator, some people are criticizing the bill because they contend it is going to give a competitive advantage to corporations that have accumulated surpluses.

Senator BARKLEY. Well, that may be.

Senator GEORGE. Mr. Haas, may I say for myself it would be far more helpful if you concede, as I think you must concede, in the light of all the business experience, that reasonable surpluses and a reasonable accumulation of surpluses was necessary, and this bill does not make impossible the accumulation of reasonable surpluses to take care of the ordinary affairs of the corporate organization.

Mr. HAAS. I agree with you perfectly, but what I was trying to explain there is the different concepts of this term "surplus."

Senator GEORGE. Oh, yes.

Mr. HAAS. Now, Senator, I agree with you perfectly, because I know you are talking about the accumulation of assets—or call it surplus, if you will—which are in such shape that you can utilize them if a contingency arises; but those assets may be expressed just as well in the capital account or separate account, I mean the capital-

stock account. Surplus is a capital account. It is just a technical matter which I was trying to explain.

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

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

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

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

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

Mr. HAAS. That is right.

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

Mr. HAAS. That is right.

Senator KING. Do you have that in this bill?

Mr. HAAS. Yes; to increase the size of business under this bill means to reinvest your earnings, and in order to reinvest your earnings you put it in surplus. The reason I discuss as much as I do the relation between capital and surplus is this—that many corporations realize that many people look at the surplus account without examining it further. I say it has little significance unless you examine the assets. They often start a new corporation out with a surplus; it is born with a surplus.

Senator KING. Is not that to take care of some contingency that may arise?

Mr. HAAS. Some State laws make it almost imperative to do that.

Senator KING. You know some businesses encounter lean years more frequently than others. You cannot standardize business.

Mr. HAAS. That is right.

Senator KING. I have in mind a mining corporation in my State. It was wisely managed. It anticipated lean years. The ore deposit in one section gave out and they had to explore. If they did not have a reserve they could not have gone to work, and they would have had to throw their men out of employment. In this particular mine they had reserves of several hundred thousand dollars. When the depression came, instead of discharging their men they kept them

at work. They made no money. They exhausted all of their reserves; and then, because their credit had been good, they borrowed \$500,000 more; and they saved the city, saved the town, saved hundreds of families. Other corporations that did not have those reserves had to close down. You would not want to adopt a policy that would preclude the cushion or the establishment of a reserve to meet contingencies of that kind, would you?

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

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

Mr. HAAS. I am coming to that.

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

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

Senator BARKLEY. Oh, yes.

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

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

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

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

Senator CONNALLY. Reserves?

Mr. HAAS. Yes.

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

Mr. HAAS. Yes.

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

Mr. HAAS. I think it is; and I will make a statement to that effect later on.

Senator CONNALLY. How is that?

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

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

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

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

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

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

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

These considerations apply no less to corporations engaged in fluctuating industries than they do to corporations engaged in stable industries. A corporation in an unstable industry will have the same opportunity that it enjoys now of accumulating capital funds during periods of prosperity, through the sale of securities to its stockholders and others, and of using these funds in such ways as it sees fit as a buffer against periods of depression.

Senator BAILEY. That is your theory right there, is it not, that the corporation will undertake to expand through the sale of securities to the stockholders rather than buying new property?

Mr. HAAS. I would say it can do that if it wishes. It can plow back earnings in small corporations to the extent of 40 percent of its annual earnings and pay a little less tax than it pays now.

Senator BAILEY. You do not say here that it can do it; you say it would have the same opportunity that it enjoys now. The difficulty is finding a purchaser for the stock.

Mr. HAAS. That is right.

Senator BAILEY. The other is getting profits out of your annual income, your operations. Now, which is easier when you come to expand?

Mr. HAAS. Well, if you wanted to hold 100 percent of your earnings, I do not think there is any question, if you wanted to hold back all your earnings. It is just a question of a bookkeeping entry, even if you issue rights for a large corporation that has access to the capital markets. There is a little more labor in that.

Senator BAILEY. The problem is one of expanding the operations of a corporation. You suggest the way to do that is to go out on the market and sell stock at whatever price you can get for the stock, you suggest that that is a feasible plan?

Mr. HAAS. That is a feasible plan.

Senator BAILEY. Whereas, under the present system, the general practice is, after you get your corporation going, to plow back a certain proportion of your profit. You explained it in that way. That is not any better way than the way of going out in the market and selling capital stock?

Mr. HAAS. That is not the way in which I put it.

Senator BAILEY. Well, read that paragraph then and see if it is not.

Senator BARKLEY. What you say is they have the same opportunity to do either under this bill that they have now.

Mr. HAAS. That is right.

Senator BARKLEY. The only difference being that the amount plowed back might be affected by the amount of tax they pay, depending on the amount they refuse to distribute to their stockholders.

Mr. HAAS. It does not prohibit them from increasing in size. These avenues are open to them.

Senator BAILEY. That depends altogether on whether you could sell the stock or not. It is rather difficult now to sell the stock.

Mr. HAAS. Well, without discussing that, I would like to give several illustrations of companies which are actually now, at this moment, issuing stock rights.

Senator BAILEY. Well, stock rights are an entirely different thing from the selling of stock.

Mr. HAAS. Yes; in stock rights; there is some coercion in that.

Senator BAILEY. This is a matter of selling stock. Take your present situation. As a matter of fact, very little stock by way of addition to the present stock of the corporation is being sold at the present time. Is there any activity in the sale of stock for new corporations?

Mr. HAAS. Is not this what you are saying us to that activity, Mr. Senator, that you give back the earnings to the stockholders that own the corporation? I mean they are the ones who are the owners, and you ask them, "Will you put it back in the company?" They say, "No." Then is not that the answer? They own the company. If on the other hand the management of the company said, "We are going to hold it whether you like it or not", that is a different proposition.

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

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

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

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

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

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

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

Mr. HAAS. That is right, and most of them during the depression could not sell stock, and many of them could not plow back earnings, either.

Senator BAILEY. What would have happened to them if they had not had big surpluses to distribute? I understand the Department of Commerce stated that they distributed \$27,000,000,000 since 1930 over and above their earnings. What would happen if they did not have those surpluses?

Mr. HAAS. Senator, I challenge that statement. I do not challenge the Department of Commerce figures, but I challenge the use which has been made of the figures. I am coming to that a little later on in my statement. I do not mean they cannot do the same thing because we are making a change in the law. I say they have the opportunity.

Senator BAILEY. You are not advocating in the sentence that has been read here that corporations pay out all their dividends and then obtain additional funds by the sale of rights of stock; all you say is they can do that if they want to.

Mr. HAAS. That is right. Thank you, Mr. Senator. I do not take any position as to the fiscal policy of the corporation, as to how much they should distribute, or anything like that. All I am saying is that this bill, if it is put into law, gives them a certain choice. What are its collateral effects? Does it give them something that is desirable or does it give them something that is undesirable?

Senator BAILEY. Is it not your suggestion that insofar as its capacity to accumulate surpluses may be impaired by this legislation, that it get new investments by selling new stock; is not that your argument?

Mr. HAAS. My argument is that a small corporation under the bill, if they want to plow back that capital, to use that method, the small corporation can plow back 40 percent and pay somewhat less than they pay now, and a large corporation, if it wants to use that method to increase its investment in business, can plow back 30 percent. It also has the other channels open to secure new capital for its business. The fact that a company is growing rapidly and increasing its surplus does not always give it this reserve that you are talking about. During the depression we found many companies that grew like a mushroom, that had nothing in the reserve account, but that might have had a surplus account. Their assets were not in a liquid form.

Senator BAILEY. Of course, that is very elementary. Surpluses are not always cash.

Mr. HAAS. That is right.

Senator BAILEY. I am not disputing that. Some of them are cash and some of them are other sources of credit.

Mr. HAAS. That is right.

Senator BAILEY. And credit is cash.

Senator HASTINGS. That statement you just made about them being able to obtain 30 percent, and so forth, as a surplus, I find that to be correct, but this is true, is it not, that in order for a corporation that has earnings of a million dollars and wants to retain 30 percent of it, or \$300,000 of it, has to pay 50 percent of the amount it retained, or \$150,000? So that while your statement on that 30 percent is correct, the truth is that they pay 50 percent of what they retain in the case of earnings of a million dollars?

Mr. HAAS. That is true, but that is the same situation now. If you want to change your taxation base you get a different percent. You have the same proposition now under the existing income-tax law, you get a figure about the same as you quoted me.

Senator HASTINGS. I am only making the statement for the purpose of clarifying the record.

Mr. HAAS. Yes.

Senator HASTINGS. The general statement that you can retain 30 percent and only pay 15-percent tax is correct.

Mr. HAAS. Yes.

Senator HASTINGS. I want the record to show that you actually pay 50 percent on the amount that you retain.

Senator LA FOLLETTE. On the other hand, it can be stated in another way, that you reduce the amount of dividend by the tax, not the amount of surplus that is retained.

Senator CONNALLY. In other words, you keep \$300,000, then you pay \$150,000, and the other \$550,000 would go into dividends. You

simply reduce the amount distributed in dividends by the amount of tax. You would still have the \$300,000 in the surplus.

Mr. HAAS. That is right.

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

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

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

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

Senator LA FOLLETTE. I do not think that is a statement of fact. The CHAIRMAN. The Government is taking no more than it took before.

Mr. HAAS. That is right.

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

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

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

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

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

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

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

Mr. HAAS. No; I would say—

Senator BAILEY (interrupting). You do not intend to do anything on that. Now, if you do not do anything in regard to that, how would you raise \$610,000,000?

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

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

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

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

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

Mr. HAAS. That is right.

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

Mr. HAAS. That is right.

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

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

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

Mr. HAAS. My staff developed those charts.

Senator BAILEY. You are perfectly familiar with the charts?

Mr. HAAS. Yes.

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

Mr. HAAS. That is right.

Senator BARKLEY. And if somebody who has not been getting a high rate of dividend gets a larger dividend because of the preference of the corporation to pay it out rather than pay a tax on it, to increase that dividend lifts that man up into the higher tax bracket and he will pay more tax. Nobody disputes that, nobody is trying to conceal that.

Senator LA FOLLETTE. As I understand it, the preparation of these charts was based on 100 percent distribution of dividends, and it simply throws one aspect on the situation, namely, where the increase would fall in case 100 percent distribution took place. That data has been prepared for the consideration of this committee and it is not to be used as a predicate for the statement that the objective of the bill is to force 100 percent distribution.

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

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

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

Senator CONNALLY. Of that which is retained.

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

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

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

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

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

Mr. HAAS. That is right.

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

Mr. HAAS. That is true.

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

Mr. HAAS. That is right.

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

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

Senator BLACK. Because by the control being exercised by a small group, as we know it is exercised in every large corporation in America, and sometimes only three men might pass on 100,000 stockholders' rights, under that system that has been operating, that group that controls the large number of stockholders can withhold the stock and pay a 15-percent tax even on the profit of the very small in-

vestor, while the larger investor might escape the 50-percent tax which other unfortunate citizens would pay who did not happen to be interested in that corporation by owning a large block of stock?

Mr. HAAS. That is right.

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

Mr. HAAS. That is right.

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

Mr. HAAS. That is right.

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

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

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

Mr. HAAS. That is right.

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

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

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

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

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

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

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

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

Senator WALSH. Mr. Chairman, I note the third objection merely deals with the claim made that this bill, if enacted into law, will drive individuals with large incomes into buying tax-exempt securities.

That is not a major feature of this bill, and I suggest it be put into the record and the witness turn to part IV to save time.

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

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

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

Mr. HAAS. What is the question?

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

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

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

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

Senator LONERGAN. I wish you would.

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

Senator LONERGAN. The Federal securities.

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

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

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

In the second place, the larger part of it already goes to individuals subject to the higher surtax rates, who, therefore, would possess little motive for selling their tax-exempt securities to others. In the third place, further increases in the amount of tax-exempt income, made available by new issues of tax-exempt securities, are not likely to be substantial. It is obvious, moreover, that wealthy individuals who sought to convert their large stock holdings into tax-exempt securities would, in the first place, face the necessity of paying substantial taxes on the capital gains realized by the sale of their present holdings. It is also obvious that large stock holdings give their possessors certain advantages other than dividend income,

such as generous salaries and immediate economic power, that they would hesitate to sacrifice. It is likewise clear that any sudden and great enlargement of the demand for tax-exempt securities would go far to drive up their prices and drive down their yields to a point that would counterbalance all or most of the tax advantage of such securities.

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

In the first place, refuge from income taxation by means of tax-exempt securities is very definitely limited by the amount of tax-exempt securities available and by the rates of interest that they pay. The largest source of tax-exempt security income is that derived from the obligations of States, counties, cities, and so forth. The net aggregate amount of such tax-exempt securities has not changed materially during the past 5 years. On June 30, 1931, the net principal amount outstanding, as estimated in the 1935 annual report of the Secretary of the Treasury, was approximately \$17,500,000,000, and on June 30, 1935, approximately \$16,900,000,000. In other words, between these two dates a decrease has actually taken place in the net principal amount of tax-exempt State, county, and municipal obligations. Further, it does not appear that the volume of tax-exempt securities will be increased in the near future at a rate anything like the rate of increase during the twenties.

The Federal Government is not now issuing any long-term obligations exempt from surtaxes. In fact, during the present administration the 3½-percent first Liberty Loan bonds and certain pre-war bond issues the interest on which was exempt from surtaxes have been refunded in part by bonds lacking the surtax-exemption privilege. The only fully tax-exempt obligation that the Federal Government is issuing to the public at the present time are short-term bills and notes.

The tax-exempt income made available by these issues, however, is far less than their principal amount would suggest. The Treasury has been borrowing at a cost of about one-tenth of 1 percent per annum on Treasury bills of 9 months' maturity, and at 1½ to 1¾ percent per annum on 5-year notes. Moreover, much the greater part of the Treasury's bill and note issues are purchased by financial and other corporations which derive no benefit from the fact that the interest on these short-term securities is exempt from surtaxes, since corporations are not subject to surtaxes in any event. That is, whereas the interest on the short-term Treasury notes held by an individual might be exempted from a surtax bracket rate as high as 70 or 75 percent, in the hands of a corporation the exemption is limited to the rate of the corporation income tax, the maximum of which is 15¼ percent in the case of consolidated railroad returns. Further, the tax exemption that corporations enjoy on the income derived from Federal obligations does not apply to the dividends based upon this tax-exempt income when the latter are distributed to the stockholders.

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

either 1½-percent 5-year Treasury notes, fully tax exempt from normal and surtaxes, or 2¾-percent 12- to 15-year Treasury bonds exempt only from normal taxes but not from surtaxes. Ninety-one and two-tenths percent of all the exchange subscriptions were made for the Treasury bonds, the interest on which is subject to surtaxes, and only 8.8 percent were made for the fully tax-exempt Treasury notes.

I would like to emphasize again that it is tax-exempt income rather than the principal amount of tax-exempt securities that is important. And I would like to point out in this connection that the declining trend of interest rates on State, county, and municipal debts, as well as on Federal obligations, is operating very powerfully to reduce the amount of tax-exempt income. The average coupon rate of interest on outstanding State and municipal bonds is estimated at about 4½ percent. A reduction of only one-half of 1 percent in the average coupon rate would be roughly equivalent to a reduction of 1,900 million dollars in the principal amount of the tax-exempt debt outstanding, so far as tax-exempt income is concerned. As against the present average coupon rate of about 4½ percent on the outstanding State and municipal obligations, it is striking to note that the interest rates on 10 typical new offerings of State and municipal bonds during the first 3 months of 1936, as listed in the appended table, run from 2¾ to 4 percent. If the present trend of interest rates continues, or even if only the present level is maintained, we can reasonably expect a reduction in the total amount of tax-exempt income as a result of the refunding of State and municipal obligations on a lower interest basis.

A fuller distribution of corporate earnings will not create a new situation so far as investment in tax-exempt securities is concerned. The existing individual income-tax rates have already fostered a considerable concentration of tax-exempt securities in the hands of individuals subject to high surtaxes, and it should be borne in mind that a further loss of revenue to the Federal Government from this source could only be caused by a transfer of such securities from individuals and institutions subject to relatively low tax rates to individuals in higher surtax brackets. The practical possibilities for such further transfers are therefore limited, both because of the existing concentration and because a large volume of institutional holdings of tax-exempts will be retained for their preeminent safety and liquidity.

Fourth. Finally, I should like to direct attention in some detail to the matter of corporate reserves and corporate surpluses, the importance of which has been greatly emphasized by critics of the President's plan and of the House bill. There has been a great deal of unfounded and misleading criticism of the President's proposal as incorporated in the House bill on the ground that the enactment of the measure would prevent the accumulation of corporate reserves needed for the maintenance of solvency and of employment during depressions. There are several sets of observations that I shall make on this point.

In the first place, the bill very definitely allows as lawful deductions, before arriving at taxable income, the usual reserves for depreciation, depletion, and bad debts. During the 5 years 1926 to 1930, inclusive, corporations in the aggregate deducted more than \$24,000,

000,000 on these accounts before arriving at statutory net income or deficit for tax purposes. During the 3 succeeding years, 1931 to 1933, inclusive, they deducted more than \$15,000,000,000 additional on these accounts, making a total for the 8 years of more than \$39,000,000,000. These deductible reserves from taxable income, which have been approximating \$5,000,000,000 a year, will be allowed under the House bill as under the present law.

Further, beyond those deductible reserves, the House bill clearly permits the retention by small corporations of approximately 40 percent of each year's current earnings and by large corporations of approximately 30 percent of each year's current earnings as additions to corporate surpluses upon payment of taxes lower in both cases than those that would be paid under the present law.

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

There are some who, though admitting the inequities of the existing system of corporation taxes, nevertheless defend it on the ground that the corporate surpluses that are thus built up free from surtaxes serve a public function by enabling corporations to maintain employment at a higher level than would otherwise be possible in periods of depression. Now, the most obvious fact bearing on this argument is that it simply did not work, as I shall show in detail shortly, when in 1929 the greatest depression this country has ever experienced came upon us. Not only do we now know that the corporate surpluses accumulated in the twenties were not used to any great extent, in the aggregate, to maintain employment during the depression but we also have some ground for suspecting that the

accumulation of these very corporate surpluses assisted materially in causing the depression. Thus, it has been argued by very responsible economic authority that among the causes of the depression was starving of consumption through the withdrawal of a too large proportion of our funds for corporate capital expenditure. Is it not quite possible that in many instances, important in the aggregate, overexpansion of plant capacity was stimulated by a desire of the controlling stockholders in corporations to reinvest earnings for the purpose of avoiding the taxes that they would have paid if earnings were distributed? It is also held by many that one of the vicious influences contributing to the great stock-market boom of the late twenties was the piling up of corporate surpluses. Stock-market speculation, which had already been stimulated by the mere piling up of such surpluses, was further stimulated by the volume of surplus funds poured into brokers' loans by corporations.

But let us examine specifically the contention that these accumulated surpluses were actually used during the depression to maintain employment, dividends, and other payments. Large figures are frequently cited to represent the aggregate losses of corporations during the depression. Either by direct statement or by implication the contention is made that these losses represent the amounts which corporations have had to pay out, in excess of their receipts, to workers, suppliers of materials, bondholders, and the like; and that only their previously accumulated surpluses allowed them to do this without bankruptcy.

We have been at pains to examine the matter a little further on the basis of the actual income-tax returns filed by corporations, and we find that the figures reported each year to the Bureau of Internal Revenue are strikingly at variance with this contention or belief. Let me cite you some of the facts that I shall present in greater detail in tables attached to this statement:

First, if we consolidate the income accounts of all corporations for each of the 3 years, 1931-33, inclusive, we find that they reported an aggregate net deficit for this 3-year period, after taxes, of 6.6 billion dollars. We also find, however, that this aggregate net deficit was arrived at after deducting some 11.2 billion dollars for depreciation, some 761 million dollars for depletion, some 3.7 billion dollars for bad debts, and some 5.1 billion dollars for loss on the sale of capital assets: deduction which, in the main, do not represent current cash outlays making for employment, dividends, and so forth. In other words, the aggregate net income of corporations before these valuation deductions, in the worst depression in history, was a little more than 14 billion dollars, and their cash dividends a little more than 13 billion dollars. For corporations as a whole, dividends, wages, and other payments, came out of current receipts, primarily, and not from accumulated "liquid surpluses." The book surpluses of corporations were indeed reduced, but they were reduced in the aggregate, not by actual cash disbursements, but by the writing-down of assets on the books of the corporations.

It may well be objected that these figures may be deceptive because they include financial as well as nonfinancial corporations. But the figures for nonfinancial corporations alone, which include all of our

manufacturing, mining, merchandising, and similar business corporations, tell the same story. Nonfinancial corporations reported a net aggregate deficit after taxes for the 3 years, 1931-33, inclusive, of 3.9 billion dollars. Their net income before valuation deductions, however, amounted to 11.1 billion dollars, and the dividends paid to 10.6 billion dollars. It is obvious that the previously accumulated surpluses of nonfinancial corporations, while reduced by valuation deductions, did not represent liquid resources that were drawn upon, in the aggregate, to pay wages or dividends. The cash and investments of all nonfinancial corporations submitting balance sheets amounted to 32.7 billion dollars at the end of 1929; at the end of 1933 they amounted to 33.5 billion dollars.

Senator BLACK. Liquid assets?

Mr. HAAS. Liquid assets; yes.

Even if we confine our attention to deficit nonfinancial corporations—that is, nonfinancial corporations reporting no statutory net income—we find that valuation deductions, rather than cash-operating losses, accounted for the largest part of their aggregate net losses during the depression. During the 3 years, 1931-33, inclusive, the aggregate net losses after taxes of these nonfinancial corporations that reported no net income amounted to 12.1 billion dollars; but 9.5 billion dollars of this aggregate deficit, or 78 percent, represented valuation deductions, primarily, rather than cash operating disbursements in excess of cash receipts. It should be borne in mind, moreover, that a corporation is included in the deficit group only in those years in which it reports no net income; so that the figures that I have just cited include the losses of all corporations during their worst years of the depression, and do not include their net income, if any, in other years of the depression.

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

Although the accounting methods of corporations vary considerably, such variations do not affect the income and deficit figures that

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

Nevertheless, these limitations of the data obtained from corporation income-tax returns do not impair the general conclusions that I have drawn respecting the character of corporation deficits during the depression and the uses made, such as they were, of the accumulated corporate surpluses. It must be emphasized, in contradiction to certain misleading statements that have gained considerable currency, that reductions in book surpluses arising in the fashion that I have outlined do not represent funds paid out to employ labor, to purchase materials, or to pay interest or dividends.

In general, then, the figures reported to the Bureau of Internal Revenue clearly indicate, first, that for corporations, as a whole, valuation deductions greatly exceeded the aggregate net losses reported during the depression; second, that valuation deductions, rather than net cash outlays, account for the largest part of the losses reported even by deficit nonfinancial corporations; and third, that corporate surpluses in the aggregate have not been drawn down in fact to maintain employment, dividend payments, and other disbursements during the depression.

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

(The tables referred to follow:)

Typical new municipal bond issues, January to March 1936

Borrower	Amount	Coupon	Average maturity	Average yield ¹
State of California	10,000,000	Percent	Years	Percent
State of Mississippi	1,500,000	2 1/4	9 1/2	2.49
State of North Dakota	2,000,000	2 1/4	4 1/2	2.16
Buffalo, N. Y.	2,000,000	3	11	3.37
Danville, Va.	1,500,000	3.30	10	3.25
Detroit, Mich.	1,513,000	3 1/4	17 1/2	3.23
Easton, Pa.	1,288,000	4	9 1/4	3.20
Houston, Tex.	2,750,000	2 3/4	17 1/2	2.65
Los Angeles, Calif.	2,102,000	3	15 1/2	3.08
San Francisco, Calif.	4,000,000	3 1/4	12 1/2	3.28
	2,700,000	4	9 1/2	2.48

¹ To original (wholesale) purchaser.

Net income, valuation deductions, and cash dividends paid, for all corporations, 1931-33

(In millions of dollars)

Year	Net income after taxes ¹	Depreciation	Depletion	Bad debts	Loss on sale of capital assets	Total valuation deductions	Net income before valuation deductions	Cash dividends	Valuation deductions as percentage of net deficit
All corporations:									
1931	\$1,178	84,000	8288	\$1,183	\$1,702	\$7,156	\$5,980	\$6,151	5600
1932	-4,114	2,092	247	1,313	1,705	6,358	2,643	3,886	160
1933	-1,323	2,496	246	1,249	1,080	6,077	3,324	3,127	493
Total	-4,644	11,192	781	3,745	3,080	20,701	14,147	12,184	313
Corporations with net income:									
1931	4,353	1,740	75	513	154	2,321	6,674	3,372	-----
1932	2,452	1,250	83	256	111	1,640	4,092	2,320	-----
1933	3,137	1,542	85	533	171	2,131	5,268	2,380	-----
Total	9,962	4,498	246	912	435	6,092	16,054	8,078	-----
Corporations with no net income:									
1931	-6,289	2,267	480	840	1,540	4,836	-603	2,279	87
1932	-6,567	2,463	164	1,077	1,264	5,318	-1,299	1,565	81
1933	-4,510	1,954	162	916	1,515	4,547	37	742	101
Total	-16,606	6,684	510	2,833	4,319	14,701	-1,905	4,586	89

¹ Statutory net income less Federal income taxes, plus dividends and tax-exempt interest received.

Net income, valuation deductions, and cash dividends paid for all nonfinancial corporations, 1931-33

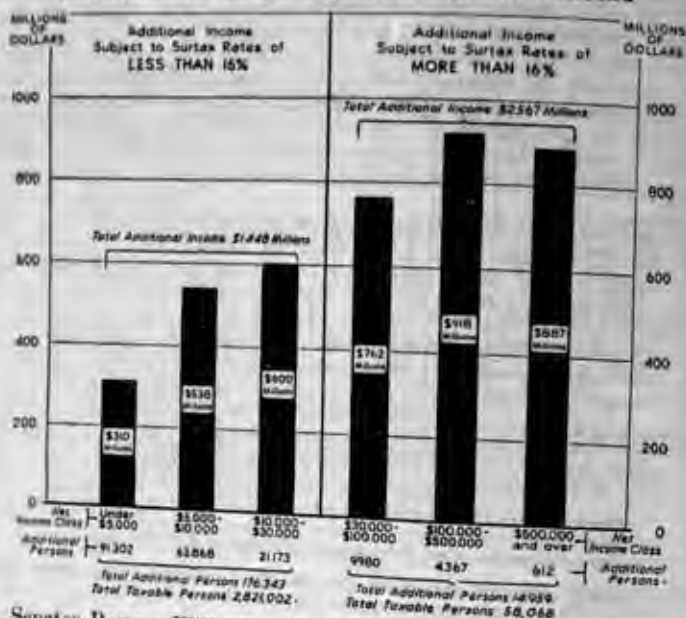
(In millions of dollars)

Year	Net income after taxes ¹	Depreciation	Depletion	Bad debts	Loss on sale of capital assets	Total valuation deductions	Net income before valuation deductions	Cash dividends	Valuation deductions as percentage of net deficit
All nonfinancial corporations:									
1931	-631	4,452	265	696	614	5,227	4,675	4,895	933
1932	-2,076	3,369	245	732	600	4,990	2,614	3,120	186
1933	-247	3,205	244	720	616	4,785	4,538	2,532	1,037
Total	-3,874	10,250	784	2,168	1,830	15,002	11,128	10,567	287
Nonfinancial corporations with net income:									
1931	3,515	1,613	77	241	100	3,031	5,545	3,371	-----
1932	1,997	1,143	82	188	61	1,475	3,472	2,068	-----
1933	2,740	1,492	84	300	104	1,980	4,720	2,158	-----
Total	8,252	4,248	244	729	265	5,486	13,738	7,597	-----
Nonfinancial corporations with no net income:									
1931	-4,165	2,839	188	454	514	3,198	-970	1,524	77
1932	-4,074	2,226	162	544	539	3,515	-1,459	1,051	71
1933	-2,966	1,713	161	420	512	2,906	-180	266	94
Total	-12,125	6,802	511	1,428	1,565	9,510	-2,409	2,970	79

¹ Statutory net income less Federal income taxes, plus dividends and tax-exempt interest received.

ADDITIONS TO TAXABLE INCOMES OF INDIVIDUALS

Assuming All 1936 Estimated Corporate Earnings Were Distributed



Senator BAILEY. Will you tell me how much the write-down was in the case you were discussing, the write-down of capital assets of corporations?

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

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

Mr. HAAS. That is right.

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

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

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

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

Senator BAILEY. The write-down is not valuable to the commerce of this country insofar as it affects the employment of people. It is not sustained by the argument. I will agree you have got some good

facts; but, after all, the write-down occurred because all values went down.

Mr. HAAS. The plant still stayed there.

Senator BAILEY. All values went down.

Mr. HAAS. That is right.

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

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

Senator BAILEY. I am not either.

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

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

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

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

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

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

Mr. HAAS. That is a legal point.

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

First, if we consolidate the income accounts of all corporation for each of the 3 years, 1931-33, inclusive, we find that they reported an aggregate net deficit for this 3-year period, after taxes, of 0.6 billion dollars.

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

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

Senator HASTINGS. All right.

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

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

Senator CONNALLY. If everybody under the present law was operating as partnerships or as individuals and we were taxing them

under the existing tax rates we would be getting just as much money—approximately the same amount of money as we propose to get under this bill?

Mr. HAAS. Yes, sir.

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

Mr. HAAS. Exactly, Mr. Senator.

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

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

Senator HASTINGS. Why did not you include 1934?

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

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

Mr. HAAS. We can get it.

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

Mr. HAAS. Yes; I will get it.

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

Mr. HAAS. Yes, Senator.

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

Mr. HAAS. Mr. Turney will answer that.

Mr. TURNER. What is the question?

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

Mr. TURNER. You mean under the proposed bill?

Senator LONERGAN. Yes, sir.

Mr. TURNER. It depends on whether or not corporation "A" declares that out in dividends to its stockholders. If corporation "B" retains 30 percent and pays 15-percent tax, the tax of corporation "A" on the 55 percent it receives will depend on the percentage that it distributes to its stockholders. If it distributes 100 percent, it will not pay any tax. If it in turn retained 30 percent, it will pay a 15-percent tax.

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

Mr. TURNER. That is right.

Senator LONERGAN. Now, would not that be a double taxation on that 85 percent?

Mr. TURNER. Well, of course, we have to apply the tax to each corporation, in order to prevent the holding of the entire income in one corporation in the chain and in order to get the money into the hands in individual stockholders.

Senator LONERGAN. Yes; but if the corporations are so closely alike in the nature of their business and the parent organization regards the subsidiary as a necessity to enable it to carry on, that is the case I have in mind.

Mr. TURNER. If the subsidiary declares all its income in dividends, the subsidiary will not pay any tax. The double taxation only occurs when you have a retention of income in both corporations.

Senator LONERGAN. You mean that could be avoided by having the subsidiary turn over all of its earnings to the parent corporation?

Mr. TURNER. Yes, sir; the corporate tax under the bill is based on the percentage of corporate income retained. If we compare the tax on an operating corporation owned by individuals, assuming a given income and amount of retained earnings, with the tax on an enterprise consisting of an operating company owned by a holding company which is owned by individuals, assuming the same income and the same total retention in one or both of the corporations, we may find two taxes, but the total amount of tax will not be more, and may be less, than in the first case.

Senator LONERGAN. Thank you.

The CHAIRMAN. Thank you very much, Mr. Haas.

STATEMENT OF FRANKLIN SPENCER EDMONDS, PHILADELPHIA, PA., REPRESENTING THE PHILADELPHIA CHAMBER OF COMMERCE

The CHAIRMAN. Mr. Edmonds, as I understand it, you represent the Philadelphia Chamber of Commerce?

Mr. EDMONDS. That is right, sir.

The CHAIRMAN. All right, you may proceed.

Mr. EDMONDS. Mr. Chairman and members of the committee, the Philadelphia Chamber of Commerce has about 2,000 members representing manufacturers, wholesalers, retailers, tradesmen of all kinds in Philadelphia. We have had for several years a committee on taxation and public expenditures, of which I have been chairman during that whole period, composed of about 45 members. We have made a study of the taxing problems from the point of view of Philadelphia. We have gathered data and we have prepared a report, sir, which we will be glad to deliver to each member of the committee. That report, on its reverse side, contains the names of the members of the committee, so you can see the businesses in which they are engaged. (See data at close of Mr. Edmonds testimony.)

Senator CONNALLY. May I interrupt you there for one question?

Mr. EDMONDS. Yes.

Senator CONNALLY. Has the State of Pennsylvania still on its statute books an act exempting manufacturers from tax?

Mr. EDMONDS. You mean the capital-stock tax?

Senator CONNALLY. I am talking about the State law.

Mr. EDMONDS. No; it has not.

Senator CONNALLY. Do you not have a law in Pennsylvania that exempts manufacturers from tax?

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

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

Mr. EDMONDS. Not today.

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

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

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

Senator KING. However, the assets were taxable?

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

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

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

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

Mr. EDMONDS. That is fine, sir. In the 13 years up to and including 1935 the United States collected \$21,994,000,000 from income taxes. That is the Federal Government. Great Britain collected \$20,002,000,000. The average annual income tax in the United States was \$1,692,000,000, and in Great Britain \$1,590,000,000.

Now, notice the variations in that same 13-year period. Our lowest income was \$747,000,000, in 1933, and our highest was \$2,410,000,000, in 1930. In other words, the disparity between the lowest and the highest amounts to 223 percent. That is the variation in the ups and downs that you get from income taxation.

Now, what was it in Great Britain? Their lowest in that period was \$1,412,000,000, in 1935, and their highest was \$1,936,000,000, in 1923. Their variation from lowest to highest is 37 percent, and ours is 223 percent.

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

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

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

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

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

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

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

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

Mr. EDMONDS. I advocate a taxing system which will give you a more stable basis. That is what I think business requires. I think this business of going up and down by 223 percent in 2 years is absurd. When you have the feast, which encourages overspending on the part of the Government, they have got the money, and when you have got the famine, that is when the people are hard up, then you have got to levy a lot of new taxes in order to make up the deficit. That is not good fiscal organization.

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

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

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

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

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

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

The CHAIRMAN. You raise a lot of tobacco for these stogies.

Mr. EDMONDS. Whatever they are they are good and they give comfort to the people.

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

Senator KING. The witness says "equable" not "equitable."

Mr. EDMONDS. I mean equable; I mean stable. From the point of view of the Government that makes a good tax; that is, a good fiscal tax.

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

Mr. EDMONDS. I am sorry I brought up the illustration. Now I will get back to my point. We have a situation in which you force out net earnings into diverse use at a more rapid rate than the necessities of business would require. You would have in 1929 and 1930 a very much higher return from the income tax than you have now, and you would have in 1933 and 1934 a very much lower return than you have now, and the result would be that you would accent the difference from the top of the hill to the pit of the valley. That is a bad arrangement.

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

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

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

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

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

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

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

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

Mr. EDMONDS. You mean the present tax law?

Senator CONNALLY. Yes.

Mr. EDMONDS. If you are asking me the question as to whether I stand for the present tax law, I say "No." I have a reputation in taxing matters, and I am sure some of the tax laws that we have had in the past have not been the laws that we should have had.

Senator CONNALLY. A minute ago you said you would want to leave it alone.

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

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

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

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

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

We have made an artificial definition of income in our laws by adding this question of capital gains and losses, and by adding capital gains and losses we have gotten ourselves into an unfortunate fiscal position in which we have this feast and famine; but I recognize that this is 1936, and you gentlemen have a practical problem before. When the time comes that you will deal with that problem, I hope you will invite me to come down, because I shall be very glad to come down.

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

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

One of the Senators asked the question about the American Telephone & Telegraph. For 1935 the net income was \$182,000,000. Cash dividends on common and preferred stock, \$167,000,000. Now, all of those corporations, in a 10-year period, have maintained dividends. The United States Steel and Westinghouse reduced their dividends somewhat, but they have paid some dividends. All of those corporations for the last 5 years were paying out more in dividends than they were getting in net earnings, but they tried to maintain regularity. When they were accumulating the peak they would be paying heavier taxes, and consequently they would not have the funds with which to make their dividend regularly. I insist, from the point of view of the government that wants regularity of income and the point of view of the investor who wants regularity of return, it is better to let those corporations smooth out the peaks and precipices themselves, and do it on a basis that will give them a regularity of return.

I had these figures put in my hands a moment ago by the president of a corporation who is in this room today. Net loss over a 4-year period prior to 1933, \$1,000,000. Profits, 1933, \$26,000. Profits, 1934, \$40,000. Profits, 1935, \$100,000. That is \$160,000 of profit made possible by increased sales. This is a retail store. But in order to

carry on that business with the increased sales they had to increase their inventory by \$100,000. That was the development of new lines. They had to increase their accounts receivable by \$75,000. That was in order to carry the new accounts. They had to make improvements in the store and in the delivery service of \$15,000. So to get that 3 years' profit required an outlay of \$190,000 from their working capital. In other words, they had to borrow money as well as use all their profits.

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

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

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

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

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

Mr. EDMONDS. No.

The CHAIRMAN. You do not know how much in the way of dividends they paid out in the last 10 years?

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

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

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

The CHAIRMAN. We are not trying to catch just some of the corporations; we are trying to make uniform laws, so that certain institutions will not allow all their earnings to be piled up to the disadvantage and inequalities of the entire situation.

Mr. EDMONDS. You made some amendment a year ago, or 2 years ago, to the taxing bill, with reference to personal holding companies and companies that expand their surplus. It seems to me that those methods that you already have are what you ought to use for exceptional cases rather than change the law for us all.

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

The CHAIRMAN. You may put that in the record.
(The article referred to is as follows:)

DRIVING OUT SURPLUSES

Perhaps the main argument put forward in favor of the proposed drastic tax on corporation surpluses is that billions of dollars are not paid out in dividends at present and hence escape the Federal tax collector. These surpluses actually do pay a tax as part of the net income of the corporations, but it is alleged that if they were paid out in dividends the Government could collect a far higher average rate on them as part of personal incomes. That there are individual corporations formed or conducted for the purpose of lowering the tax rate which very wealthy individuals would otherwise have to pay is doubtless true. The revenue laws, however, already provide penalties where corporations are used for the purpose of tax evasion. Whatever the Treasury may gain in a single year by "driving out the surpluses", its probable gains over a series of years would be much more dubious.

Nothing could make this clearer than the table compiled from Treasury Department reports by the National City Bank in its March bulletin. Below is a simplified form of the table showing the taxes paid, net earnings, and dividends of all manufacturing corporations in the United States for the years 1921 to 1933:

Year	Taxes paid	Net income after taxes	Dividends paid
1921	\$795,000,000	\$172,000,000	\$1,215,000,000
1922	890,000,000	2,251,000,000	1,308,000,000
1923	980,000,000	3,086,000,000	1,761,000,000
1924	1,037,000,000	2,334,000,000	1,631,000,000
1925	1,077,000,000	2,154,000,000	1,908,000,000
1926	1,130,000,000	3,124,000,000	2,116,000,000
1927	1,085,000,000	2,583,000,000	2,726,000,000
1928	1,118,000,000	2,365,000,000	2,507,000,000
1929	1,161,000,000	2,802,000,000	2,575,000,000
1930	952,000,000	801,000,000	2,613,000,000
1931	731,000,000	1,958,000,000	1,894,000,000
1932	647,000,000	1,006,000,000	1,115,000,000
1933	852,000,000	1,000,000,000	1,009,000,000
Average	948,000,000	1,630,000,000	1,838,000,000

Deficit.

The following facts emerge from this table: For every dollar that the corporations paid to their shareholders for the use and risk of capital, about 52 cents was paid in taxes to the Federal and local governments. The shareholders, in addition, later paid income surtaxes on the dividends they received. What is more significant from the standpoint of the proposed tax, these corporations actually paid out over this period of 13 years a higher annual average sum than their net earnings. While net earnings regularly exceeded dividends for the 8 years from 1922 to 1929, in the next 4 years dividends paid out of accumulated surpluses greatly exceeded current earnings.

Wholly apart from the social effects of the proposed tax on surpluses in aggravating the violence of the business cycle and in retarding the rate of industrial growth, one may ask whether it is not short-sighted, even as a Government fiscal policy. Over a period of 13 years manufacturing corporations, taken as a whole, actually did pay out in dividends even more than their full statutory net income in that period. It was fortunate for the Treasury that they paid it out as they did. If they had paid out everything in the years from 1922 to 1929, there would have been a much more greatly shrunken volume of dividends during the depression to tax in personal incomes than there actually was. The new policy, if adopted, would tend to increase the violence of the fluctuations in the Federal Government's income, making dividends higher than otherwise, whether other tax sources were higher and lower than otherwise, when other tax sources were lower.

Mr. EDMONDS. Here is the average. They paid 948 millions in taxes, and their net income, after taxes, the average, was \$1,630,000,000. The dividends they paid were \$1,838,000,000. In that period their

average shows something like \$200,000,000 per year distributed more than their net earnings in that period, and that shows how the tendency is to equalize the feast-and-famine proposition by wisely managed corporations.

Senator BAILEY. And to maintain the constant buying power.

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

Senator BARKLEY. Let me ask you a question first.

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

The CHAIRMAN. That is so stated in the bill.

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

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

It is my very clear feeling that we would go out of the depression only by encouraging new industries. It is the new industries that must take up the slack of unemployment. How can they do that? In our report we give you a special illustration of the Budd Co. of Philadelphia. Edward B. Budd is a man who is a genius in dealing with metals. He started 30 years ago making automobile tops, and he has a pretty large business along that line. For the last 5 or 6 years he has paid no dividend. They have spent 6 years in experimenting with stainless steel. They did not invent stainless steel, but they did fabricate it, and they were the first company that was able to fabricate it. They spent a million and a half of their accumulated net earnings in trying to solve that problem. And what have they done? They have given a new industry to the United States today. Those zephyr trains on the western plains, for which the order is coming in now, is one of the things that they are fabricating this stainless steel for. The Federal Government has required some of this stainless steel fabrication for the superstructure of the war vessels. Mr. Budd tells me that he has put into that development 600 men employees who were not employed a year ago. He has orders that will increase employment possibly to 1,100 before the end of the calendar year.

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

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

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

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

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

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

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

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

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

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

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

Senator BARKLEY. Well, the legislation was necessary because we could not have a genuine prosperity in this country unless agriculture shares in it, and although for 10 years you have been boasting of artificial prosperity in other classes, everybody knows the condition of the farmer had been growing more serious all the time.

Mr. EDMONDS. If you will make a bargain with me—I will say if you will not put on me the sins of my party, I will not put on you the sins of your party.

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

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

Senator BARKLEY. I am speaking to you not in an individual way. It was the boast of business in the whole country. They are opposed to any legislation that is designed artificially to remedy a situation that was created artificially. Now, whether we were wise in the passage of the Agricultural Adjustment Act or not, it increased the farmers' income over \$1,000,000,000 a year. It enabled him to begin paying his debts and to buy some of the things that your factories produce. You may or may not agree with that program, but it was adopted, and it is the only one that has been adopted in 20 years that worked, although the Supreme Court held it unconstitutional, which they did way back in 1890, when we passed an income-tax law, and which they have done some 65 times since the Government was organized in 1787. So there is nothing peculiar about the fact that the Supreme Court declared that particular law unconstitutional and declared one or two others unconstitutional.

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

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

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

Mr. EDMONDS. I was giving you an answer that our committee gives out, and it says very frankly that it is the demand of business that you save this money by cutting down expenses. Now, let me give you my personal answer. I think we are tied to the cross, and it is a very sad condition that we are in. I think that you gentlemen have sometimes lost sight of the fact that you are not supposed to be the heavy money spending end of the Government. Ordinarily the Federal Government used to spend about $3\frac{1}{2}$ billion dollars, and the State and local governments spent 8 billion dollars. In place of that I think you have got the Federal Government spending about 8 billion dollars. What is the result of that? You are gradually impoverishing the assets on which local governments are going to support themselves.

Senator BARKLEY. We have to do that, because the local governments came to Washington and laid their burdens on the doorstep of Uncle Sam. They said, "We have exhausted our resources, we have

exhausted our taxing ability. We cannot borrow any money." Therefore, Uncle Sam had to assume the burden. We had to assume it or allow millions of people to starve or freeze. We did not assume the burden because we want to do it. I would be glad to get out from under it tomorrow, so far as the whole program of Uncle Sam is concerned, if we could do it, but we cannot.

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

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

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

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

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

Mr. EDMONDS. Yes.

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

Mr. EDMONDS. I do not think, personally, that it would. I think it would be an encouragement to established business that has its surplus before January 1, 1936, and it would be a terrible discouragement to the young man who is starting out in business with little capital.

Senator GEORGE. We cannot go back and remedy that.

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

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

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

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

Mr. EDMONDS. To that question my answer is "No." I think you would discourage tremendously new business, and you would dis-

courage the small businesses that grow into the big businesses that seem to be worthy of encouragement.

Senator LA FOLLETTE. Under the illustration you gave the fact is that under this bill that corporation would retain 40 percent, is that true?

Mr. EDMONDS. I think that is true. It is 40 or 30 percent. That, by the way, is the last point that I wanted to touch on. May I say this, Senator, I have a very high regard for the Senate of the United States. I hope very much, when you frame a tax bill that you will frame it in understandable English. My feeling is that the bill you have got before you now does not contain understandable English for the average man. Now, I have read it, I have gone over it with my partners, and it is quite clear to me that you cannot understand it except by taking a practical illustration and working it out.

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

Mr. EDMONDS. That will be fine.

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

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

Senator BLACK. Are you an attorney?

Mr. EDMONDS. Yes; I am an attorney.

Senator BLACK. What is the name of your firm?

Mr. EDMONDS. Edmonds, Obermayer & Rebmann, in Philadelphia. (The report referred to by Mr. Edmonds is as follows:)

REPORT OF COMMITTEE ON TAXATION AND PUBLIC EXPENDITURES

PHILADELPHIA CHAMBER OF COMMERCE,
April 15, 1938.

To the Board of Directors, Philadelphia Chamber of Commerce:

The committee on taxation and public expenditures respectfully submits the following report:

From the point of view of taxation, every citizen is subject to three authorities, viz, the Federal, State, and local governments.

During the period of the depression additional duties have been assumed by each of these governments, and as a result they have been obliged to raise additional funds, in some cases by taxation, other cases by selling bonds, and in other cases by borrowing money on short-term loans. The pressure upon each branch of government has led to the raising of money by any device that may accord with the temporary necessity of the moment, and as a result the tax system has become unstable, uncertain, and unnecessarily complicated.

At present the Federal Government is considering a new revenue measure estimated to produce from \$900,000,000 to \$700,000,000. The State government has announced that there will be a special meeting of the general assembly to

provide additional revenue for relief. Under these circumstances it is the duty of all citizens to consider the general subject and to give their best advice to their representatives. Consequently we outline herewith the courses of action which we are prepared to recommend to our representatives in Congress and in the general assembly of the State.

I. GENERAL PRINCIPLE

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

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

II. FEDERAL GOVERNMENT

There is now pending in the Congress of the United States a proposition which is expressed in the report of a subcommittee of the Committee on Ways and Means of the House of Representatives, but which at the time of the preparation of this report has not yet been reduced to the form of a bill. In principle it is proposed to abolish the Federal corporation income and capital-stock taxes and to substitute therefor a graduated tax upon the net earnings of corporations, the rate increasing with the proportion of net earnings that shall be attained after January 1, 1936, but not distributed as dividends to stockholders. It is furthermore proposed to extend the normal personal income tax so as to apply the same to the dividends which taxable receive. It is claimed that these principles will result in a reduction in the taxes paid by corporations to the Federal Government, but in an increase in the returns of the personal net income tax to so great a degree as to provide for the losses resulting from the reduction in corporation taxes, with a net additional revenue in excess of \$900,000,000.

The proposal for a graduated tax on net earnings of corporations not distributed as dividends is not new. It was considered in Congress in 1921 and in later years, and it has frequently been advocated by those whose point of view has been fastened upon the relatively few corporations, some of which are more or less personally controlled and which by accumulating net earnings save to their stockholders the burden of paying personal income tax upon dividends which might otherwise be declared. It is to be noted that under existing law, sections 302 and 351 (the latter enacted in 1934), provide a present method of taxing undue corporate surpluses. The advocates of this principle contend that if an individual makes money he pays personal income tax thereon; that if a partnership makes money the partners pay income tax upon the entire amount of the profits; but that if a corporation makes money the stockholders only pay personal taxes upon so much of the earnings as may be distributed to them.

While this argument is persuasive, we are convinced that it does not meet the necessity of the American people at the present time for the following reasons:

(a) As a result of the prolonged depression the surpluses of many corporations are exhausted, and in justice to the business they should be renewed without or hindrance from the Federal Government.

(b) While the argument that a stockholder in a corporation is in a favored position as compared with a partner or an individual has force, yet it entirely overlooks the fact that the corporation net income tax is designed to meet precisely this situation.

(a) Experience has shown that in the larger industrial corporations the accumulation of a surplus has tended toward stability in dividends, provided the average of net earnings is maintained. This stability in dividends assures a regular income to the stockholder and a stable income tax to the Government, whereas legislation encouraging corporations to distribute all or a larger part of their net earnings in dividends will inevitably result in a large dividend in a year of prosperity and a small dividend or no dividend in a year of depression, thereby depriving the stockholder of a regular dividend, and, furthermore, promoting wide variations in governmental income.¹ The new proposal will doubtless encourage an immediate increase in dividends, which, under present conditions, will be a sign of a temporary prosperity rather than a herald of a permanent prosperity.

(d) The proposal loses sight altogether of the great use which has been made by many industrial corporations in the building up of business and plan through the wise use of surpluses. The experience of the Ford Motor Co., which today represents an investment out of earnings of \$700,000,000 and gives employment directly to 70,000 men and indirectly to thousands additional from an original cash investment of \$40,000, is an illustration of this principle. We are convinced that the way out of the depression is through the development of new ideas, and that nothing is so conducive to such a development as the wise use of corporation earnings in research, analysis, and experiment in order that new ideas may be prepared for the market. As an illustration of what can be done along this line, we refer to the example of the Budd Co. in Philadelphia, which spent more than one and one-half million dollars from its surpluses and 4 years in experimentation upon stainless steel before an adequate method of fabricating this product could be developed. As a result this branch of the Budd Co. is today employing 600 men who were not employed 2 years ago, and has already received orders which will require 1,100 employees in this department, this being a substantial fraction of the 6,500 men presently employed in the plant. This company affords an excellent illustration of the way in which unemployment can be relieved through the development of new ideas.

In a general way, the English promote new ideas by the sale of stock, but this plan is not in harmony with the American tradition. We believe that it would be difficult to finance new ideas in America by the sale of stock to any adequate degree. Industrially speaking, our country is dynamic and not static. We expect continuous improvements in process and ideas, and these improvements have been developed in large measure through the practice of putting back into the industry earnings of our businesses, resulting in larger plants, greater facilities, new ideas, and additional employment. It will be a sorry day for America when its Government should decide to discourage this practice.

(e) It is to be noted that the suggestion contained in the report of the subcommittee will not result in balancing the Budget in 1937. If the income of the corporation is not distributed as dividends until after the first of the year, it will be another year before it is reported in the income of the individual stockholder. It is apparent, therefore, that this taxing plan is not based upon any idea of bringing the Budget into prompt balance.

(f) There are a number of other objections to the proposed plan of taxation, such as the necessity for eliminating corporations engaged in banking and insurance where the growth in surplus is necessary in order that they may continue their service to the public, the status of corporations which have borrowed extensively during the period of the depression and are under contract to repay their debts, the status of those corporations which are required to restore depleted sinking funds or capital before they can distribute any dividends to their stockholders.

For all of these reasons we submit that the plan of taxation now under consideration before the National House of Representatives is fiscally unsound and will work an economic hardship on the American people, delaying the period of recovery which is so profoundly desired.

¹In the period of 11 years, 1925-35, inclusive, the following results are noted: (1) Allied Chemical & Dry—has paid dividends in each year, and for 2 years the dividends were in excess of the net income; (2) American Telephone & Telegraph—has paid dividends in each year, and for 4 years the dividends were in excess of the net income; (3) General Electric—has paid dividends in each year, and for 4 years the dividends were in excess of the net income; (4) United States Steel—has paid some dividends in some years and for 3 years the dividends were in excess of the net income, and for 5 of those years dividends were in excess of the net income, and for 3 of those years there was a deficit; (5) Westinghouse Electric & Manufacturing—has paid some dividends in each year, and for 5 years the dividends were in excess of the net income, and for 3 of those years there was a deficit.

Under these circumstances we advise our Representatives in Committee to consider first the needs of Government, and when a sum is fixed for ordinary expenditures, together with the welfare need indicated above, has been determined, then to consider the question as to how the money shall be raised; and in this effort the Philadelphia Chamber of Commerce will be glad to cooperate.

III. STATE GOVERNMENT

The Governor of Pennsylvania has announced that the general assembly will meet in special session in the week of May 3, and it is understood that one of the primary needs of the session will be the provision of additional revenue for problems arising out of the spring floods and unemployment relief.

During the past 10 years the State of Pennsylvania has enacted its new taxes; of which 8, not including the personal income tax, which has been declared to be unconstitutional, were enacted in 1935. We recommend to the Governor and the legislators the careful consideration of the following questions:

(a) What revenue has been produced by the eight new taxes imposed in 1935, and what may fairly be expected for the biennium for which these taxes were imposed?

(b) What has been the cost of collecting this revenue?

(c) Are there any of the ordinary costs of State government which can be reduced in order to provide a fund for the unemployed? It will be recalled that the special session of 1932 reduced the Budget appropriations by a sum in excess of \$13,000,000 in order to provide funds for unemployment in that year.

(d) In view of the wide disparity in the estimates emanating from informed sources, we ask the question:

What is the real need in Pennsylvania to provide for its unemployed, and is it not possible that this need can be estimated with sufficient finality and accuracy to satisfy the taxpayers?

When these questions have been adequately answered, we believe that Pennsylvania will be ready to provide the funds necessary to care for its unemployed, but until these questions are adequately answered, it will be difficult to secure the cooperation of the tax-paying public.

IV. LOCAL GOVERNMENT

We commend the city of Philadelphia upon the improvement in tax collections.

The receiver of taxes reports for the first 3 months of 1936 that total city tax collections from all sources were \$47,796,581, an increase of \$3,925,200 over last year. There is an increase in the collections of city taxes, school taxes, personal-property taxes and delinquent taxes. There is a small decrease in water rents.

Recent negotiations which have been pending in the United States district court suggest that it is possible that a settlement may be reached between the city of Philadelphia, the Philadelphia Rapid Transit Co., and the owners of the underliers in the transit system. It is proposed that the consideration for the purchase of the underliers shall be paid in Philadelphia bonds. In the event that these negotiations result in an issue of municipal bonds, and the payment in cash to the underliers, we recommend to the mayor and city council the advisability of authorizing an issue of serial bonds for this purpose. In 1927 the Philadelphia Chamber of Commerce appointed a special committee to consider the relative advantages of serial and sinking-fund bonds for the city, consisting of Sydney P. Clark, Frank M. Hardt, Edward Hopkinson, Jr., Walter E. Long, Roland L. Taylor, and Joseph B. Van Dorn. This committee unanimously recommended serial bonds. The chairman of this subcommittee, Mr. Clark, has prepared a memorandum which is attached to this report which indicates the practice in other American cities.

During the past 5 years there have been a number of disputes with reference to the administration of the sinking funds and the appropriations which should be made from the public treasury. We believe that the time has come to inaugurate a system of serial bonds on which the appropriation for interest and retirement will be a definite matter of computation without requiring the intervention either of expert accountants or of the courts of law.

It is to be noted that the city is under the immediate necessity of providing additional money for the sinking fund. Under the decision of the Supreme Court

on January 8, 1936, the city was directed to pay forthwith to the sinking funds the sum of \$7,987,015.04 for the requirements of 1935. But \$1,000,000 has thus far been provided, and we recommend to city council to formulate at once a plan for this payment, and to this end to inaugurate a policy of strict economy in the municipal business.

V. CONCLUSION

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

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

Respectfully submitted.

TAXATION AND PUBLIC EXPENDITURES COMMITTEE.

Memorandum for: Philadelphia Chamber of Commerce.

Prepared by: Mr. Sydney P. Clark.

TAXATION AND PUBLIC EXPENDITURES COMMITTEE.

April 15, 1936.

The conclusions and recommendations contained in the report of the subcommittee on serial bonds of the committee on taxation and public expenditures of the Philadelphia Chamber of Commerce, dated January 1927, hold true today. We are, therefore, outlining in this memorandum the practices followed by certain municipalities in the United States and in the State of Pennsylvania, other than the city of Philadelphia, with regard to the issuance of municipal bonds in either term or serial form. For purposes of comparison throughout the United States we feel that an examination of the form of debt outstanding in each of the first 10 cities of the country will serve to indicate the general practice and trend. The first 10 cities of the United States by population are as follows: New York City, N. Y.; Chicago, Ill.; Philadelphia, Pa.; Detroit, Mich.; Los Angeles, Calif.; Cleveland, Ohio; St. Louis, Mo.; Baltimore, Md.; Boston, Mass.; and Pittsburgh, Pa.

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

The city of New York utilizes both forms of municipal bonds—sinking fund and serial. The sinking fund, or term bonds, are known as "corporate stock" and mature within 50 years after date of issue. Corporate stock usually is issued to finance the cost of capital improvements of a revenue-producing character, such as water, rapid-transit and dock properties. Serial bonds are issued to finance capital improvements, and the final serial maturity must not exceed the life of the improvement financed, and the maximum maturity in any case must not exceed 50 years. As of January 1, 1935, there was outstanding corporate stock in the amount of approximately \$1,633,000,000 par value, and serial bonds in the amount of approximately \$442,000,000 par value.

Chicago, Ill., population 1930 census, 3,376,438

The city of Chicago had outstanding in December 1935 approximately \$208,000,000 par-value serial bonds, and approximately \$32,000,000 sinking-fund bonds. The sinking-fund bonds were issued in 1933 and 1935 for refunding purposes.

Philadelphia, Pa., population 1930 census, 1,950,961

In December 1935 the city of Philadelphia had outstanding approximately \$300,000,000 par-value bonds, all of the sinking-fund type.

Detroit, Mich., population 1930 census, 1,500,662

Detroit presents a special situation inasmuch as the city defaulted on its debt service in February 1933 and effected a reorganization of its debt which became operative about a year later. Briefly, the city of Detroit refunded principal amounts of bonds maturing up to July 1, 1943, into 30-year bonds bearing the same coupon rate and callable any interest date at 100. It is to be noted, however, that as market conditions have warranted during the past 2 years the city of Detroit has called certain of the 30-year refunding bonds referred to above and replaced them with serial issues.

Los Angeles, Calif., population 1930 census, 1,238,048

In December 1935 Los Angeles had outstanding approximately \$195,000,000 par value of bonds, all in serial form, with the latest maturity 40 years from date of issue.

Cleveland, Ohio, population 1930 census, 900,429

In December 1935 Cleveland had outstanding both types of municipal bonds—sinking fund and serial. All of the sinking fund, however, were issued in 1921 or prior thereto. The city has issued serial bonds since 1914 along with sinking-fund issues. However, as noted above, no sinking-fund bonds have been issued since 1921. The approximate relative par value of each type of bonds outstanding in December 1935 is as follows:

Sinking-fund bonds	\$21,000,000
Serial bonds	97,000,000

St. Louis, Mo., population 1930 census, 821,900

The city of St. Louis has outstanding both types of bonds, sinking fund and serial. Until 1935 all sinking-fund bonds were dated 1923 and prior thereto. In 1935, however, the city issued approximately \$2,500,000 par value of term bonds for refunding purposes. The approximate relative par value of each type of bonds outstanding in December 1935 was as follows:

Sinking-fund bonds	\$3,700,000
Serial bonds	75,600,000

Baltimore, Md., population 1930 census, 804,874

In December 1935, with the exception of approximately \$800,000 par value sinking-fund bonds, issued in 1933 and 1934, the city of Baltimore had outstanding approximately \$58,000,000 par value term bonds, dated 1912, or prior thereto, and approximately \$130,000,000 par value serial bonds.

Boston, Mass., population 1930 census, 781,188

Boston continues to utilize both types of municipal bonds, sinking fund and serial. The approximate relative par value of each type outstanding in December 1935 is shown below:

Sinking-fund bonds	\$88,900,000
Serial bonds	90,000,000

It is interesting to note, however, that of the approximate par value of sinking-fund bonds outstanding, noted above, only approximately \$19,000,000 par value have been issued since 1930.

Pittsburgh, Pa., population 1930 census, 609,817

In December 1935 the city of Pittsburgh proper had outstanding only serial issues. There are certain small political subdivisions which have been incorporated within the city at various times and whose bonds the city has assumed. Of these assumed bonds approximately \$1,000,000 par value are of sinking-fund type and are dated 1921 and prior thereto, serial bonds of the city of Pittsburgh outstanding in December 1935 amounted to approximately \$60,000,000 par value.

The first 10 cities in Pennsylvania in point of population are Philadelphia, Pittsburgh, Scranton, Erie, Reading, Allentown, Wilkes-Barre, Altoona, Harris-

burg, and Johnstown. We have considered Philadelphia and Pittsburgh above in the first 10 cities in the United States, so we will eliminate them from consideration in Pennsylvania.

Scranton, Pa., population 1930 census, 143,431

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

Eric, Pa., population, 1930 census, 143,433

The city of Eric has a total of \$125,000 term bonds, all issued in 1910. The balance of approximately \$7,500,000 par-value bonds are all in serial form.

Reading, Pa., population, 1930 census, 115,967

The city of Reading has a total of approximately \$150,000 par-value term bonds, issued in 1912 and 1913. The balance of approximately \$6,750,000 par value of bonds are all in serial form.

Allentown, Pa., population, 1930 census, 92,563

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

Wilkes-Barre, Pa., population, 1930 census, 86,626

All of the outstanding bonds of the city of Wilkes-Barre are in serial form.

Altoona, Pa., population, 1930 census, 82,054

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

Harrisburg, Pa., population, 1930 census, 80,333

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

Johnstown, Pa., population, 1930 census, 66,993

The city of Johnstown has approximately \$1,000,000 par value of term bonds, dated 1922 or prior thereto, and approximately \$3,300,000 par value of serial bonds.

Without going further into the division between sinking-fund and serial bonds in other individual cities, it is true that in Pennsylvania and throughout the United States as a whole the sinking-fund issue is the exception and the serial issue the rule.

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

City	Population 1930 census	Approximate number outstanding December 1935		
		Sinking fund	Serial	Percent serial
New York	5,930,446	\$1,600,000,000	\$442,000,000	21.70
Chicago	2,376,435	32,000,000	208,000,000	86.87
Philadelphia	1,959,961	500,000,000	(?)	100
Los Angeles	900,429	21,000,000	97,000,000	82.20
Cleveland	821,960	3,700,000	75,500,000	95.09
St. Louis	804,874	58,800,000	130,000,000	68.86
Baltimore	781,188	88,000,000	50,000,000	55.21
Boston	669,817	1,000,000	60,000,000	98.36
Pittsburgh				

(On small political subdivisions whose bonds the city proper has assumed.

) All bonds.

(Detroit omitted from above list because of situation described in enclosed report.)

The above figures are subject to comments in the attached report.

Practice of eight largest cities in Pennsylvania (excluding Philadelphia and Pittsburgh) as to issuance of sinking fund or serial bonds

City	Population 1930 census	Approximate number outstanding December 1935		
		Sinking fund	Serial	Percent serial
Scranton	143,431	(?)	(?)	100
Eric	143,433	\$225,000	\$7,500,000	95.85
Reading	115,967	150,000	6,750,000	97.83
Allentown	92,563	2,400,000	2,000,000	82.28
Wilkes-Barre	86,626	(?)	(?)	100
Altoona	82,054	3,200,000	1,500,000	31.92
Harrisburg	80,333	(?)	(?)	100
Johnstown	66,993	1,000,000	3,300,000	76.74

(All bonds.

The above figures are subject to comments in the attached report.

STATEMENT OF M. L. SEIDMAN, NEW YORK CITY, CHAIRMAN, TAXATION COMMITTEE, NEW YORK BOARD OF TRADE, INC.

The CHAIRMAN, Mr. Seidman, you are chairman of the taxation committee, New York Board of Trade?

Mr. SEIDMAN, Yes, sir.

The CHAIRMAN, All right; you may proceed.

Mr. SEIDMAN, Gentleman, this bill proposes, chiefly, an undistributed profits tax on corporations. In actual fact, it is not a tax at all that is proposed, but a penalty, leveled against corporations who fail to distribute their entire net income to their stockholders.

Senator LA FOLLETTE, How can you make that statement when it is a fact that under this bill a corporation can retain 30 percent if it makes more than \$10,000, if it is undistributed and pays less tax than it pays now, and the corporation that makes under \$10,000 can retain 40 percent?

Mr. SEIDMAN, That is true; but inasmuch as a corporation is let go scot free if it distributes all of its income, and then necessarily, to the extent that it does not distribute it is penalized. That is the extent of my statement.

Senator LA FOLLETTE, Your statement is not a correct statement concerning this bill, as I understand it.

Mr. SEIDMAN, I say if they distribute all of their income they go scot free. If they distribute all of their net income, they go scot free of tax. If they do not, they must pay as much as 42½ percent of their entire net income, or an equivalent of 73.9 percent of the net income retained.

Senator BARKLEY, If they do not distribute anything, then the stockholder goes scot free. So somebody is going scot free in any event.

Mr. SEIDMAN, If they do not distribute anything, there will be no dividends to the stockholders to be taxed.

Senator BARKLEY, Sure.

Mr. SEIDMAN, I say this, gentlemen, that they are charging a business 73.9 percent for the right to retain its own working capital. That is an outrage under any tax system and under whatever name the tax is imposed.

Senator LA FOLLETTE. You do not think, do you, that the stockholders have any right to any earnings?

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

Senator BLACK. Do you think it is an outrage for an individual to pay 73.9 percent if he makes that much profit?

Mr. SEIDMAN. I certainly do.

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

Mr. SEIDMAN. I think it defeats itself.

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

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

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

Mr. SEIDMAN. I am a certified public accountant.

Senator BLACK. You appear in your own capacity?

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

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

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

Senator BLACK. You are not employed by them?

Mr. SEIDMAN. I am not employed by them.

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

Mr. SEIDMAN. Yes, sir.

Senator BARKLEY. What is that firm?

Mr. SEIDMAN. Seidman & Seidman, New York City.

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

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

Much criticism has been directed against the basic theory of the undistributed-profits tax. I believe that many of such objections can

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

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

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

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

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

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

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

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

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

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

Senator BARKLEY. I suppose it is not worth while spending time on it, but have you ever figured that if you tax all of these public securities, like the bonds of States, counties, and cities, and the

United States, which bears a low rate of interest because of their nontaxable character, that the interest rates would be raised and that the people would have to pay more interest on their public obligations? It would be the same as taking money out of one pocket and putting it into another.

Senator KING. And furthermore, the bonds would sell for less.

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

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

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

Mr. SEIDMAN. The maximum normal and surtax rates now total 70 percent. In addition, there is usually a substantial State income tax to be reckoned with. There is thus almost complete confiscation of income in the top brackets. The only haven for the taxpayer in that position is the tax-exempt security. It is useless to impose any such tax rates and expect to collect them to any substantial extent as long as that avenue of escape exists. The proposal to eliminate tax-exempt securities has been made to the Congress almost annually, but always it has been sidetracked. It would seem that the least that should be done in that regard is for this administration to stop pouring out additional billions of dollars in tax-exempt securities. That would be more convincing evidence of good statesmanship than almost anything else that has been said or done to reform our tax system.

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

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

Senator GEORGE. We make some allowance here for depleted capital.

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

In referring to depleted reserves, I do not necessarily mean that these companies have no surpluses. Their balance sheets might show substantial surpluses over and above paid-in capital. But businessmen understand that a corporation's surplus, as shown by its balance

sheet, is seldom represented by cash or its equivalent. Quite to the contrary, such surpluses are usually tied up in plant, equipment, and merchandise inventory.

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

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

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

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

Senator KING. You mean net income?

Mr. SEIDMAN. Net income.

Senator GEORGE. That is where it keeps it all.

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

I think that would simplify the whole complicated rate-schedule structure.

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

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

Also—

To the extent that corporations do not disburse their current earnings, the additional revenues will be obtained from higher corporation income taxes corresponding as near as may be on the average to the rates that would have been by their shareholders if corporate earnings were fully distributed.

The point he is trying to make here is we ought to tax a corporation that does not distribute at about the same average tax rate as the normal and surtax would be imposed against the individual stockholder if the distribution were in fact made.

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

Here is a rank inequality in taxing business profits. It certainly runs counter to one of the avowed purposes of the law which in the words of the President himself, seeks "a fairer distribution of the tax load among all the beneficial owners of business profits, whether derived from unincorporated enterprises or from incorporated businesses, and whether distributed to the real owners as earned or withheld from them."

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

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

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

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

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

Senator LONERGAN. Yes.

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

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

Mr. SEIDMAN. The corporation has earned \$100,000 and has retained \$50,000 in reserve.

Senator BLACK. Yes.

Mr. SEIDMAN. Distributing the remaining \$50,000?

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

Mr. SEIDMAN. Under the plan here?

Senator BLACK. Who pays the tax on that?

Mr. SEIDMAN. The answer to that question directly is the stockholder pays the tax either directly or indirectly.

Senator BLACK. Who pays it? Out of what fund does it come?

Mr. SEIDMAN. It comes out of the corporation's assets, of course.

Senator BLACK. The first \$50,000 is held in reserve, it is put into the corporate fund. Who pays the tax on the \$50,000 that is distributed?

Mr. SEIDMAN. The stockholders.

Senator BLACK. Do you find any double taxation in that particular instance?

Mr. SEIDMAN. No; but you have got—

Senator BLACK (interrupting). That is the whole plan.

Mr. SEIDMAN. You have an illustration there of a single corporation that has had \$100,000 of its income taxed.

Senator BLACK. You stated that this bill provides for double taxation. The bill provides for the part of the profits reserved that the taxes are to be paid by the corporation, and for the part of the profits that is paid out by the corporation the taxes on that shall be paid by the person to whom it is distributed. Do you call that double taxation?

Mr. SEIDMAN. I said double taxation appears only at this point: Where the corporation, to simplify the example, retains all its earnings, it pays the average surtax rate for every dollar of its earnings as if it were, in fact, distributed to the stockholders, and if ever in the future that profit is distributed to stockholders they again are called upon to pay both the normal tax and the surtax. I say that is wrong; that is double taxation of the worst kind.

This double taxation of income also emphasizes the fact that several hundred million dollars of revenue estimated to be produced by this bill will come about only as a result of taxing twice income that has heretofore been taxed only once.

Why should a stockholder in a small and poorly financed corporation, having suffered his share of tax through direct payment by the corporation, be again required to pay a tax on the same income when he comes into actual possession of his share of what is left of it after the corporation has paid the tax? If such distributions are to be again subjected to tax as is proposed, why is not the shareholder at least entitled to a credit against his tax for his pro-rata share of the tax paid by the corporation on what is left of the very same income?

That is the system England has employed for many years, and, as a matter of equity and fairness, should be pursued here if income-tax laws are not to completely topple over by the very weight of their own inequities. Such a plan as is here proposed must eventually work its own destruction. The quicker that is understood, the better for all concerned.

It may be contended that such tax duplication is justified by the Government's fiscal needs. Let us then remember that no tax program will catch up with the policy of spending \$2 for every \$1 taken in. But, if such revenue must be raised through the income tax, let it be raised by a broadening of the tax base, through an increase in the normal tax and a lowering of the tax exemptions, so as to directly include a large number of our people who are today paying huge taxes in disguised form, concealed in the price of the things they buy.

Such a broadening of the tax base should be designed deliberately (to bring home to our people the cost of our enormous Government spending which they, the people, must ultimately pay for.

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

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

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

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

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

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

Mr. SEDMAN. No. I say let the corporation pay the tax on that, but then label that income tax free whenever it is distributed, it is tax-free to the stockholder. That is exactly what you have done in section 1 or 2.

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

Several other serious defects in the bill should receive consideration. The present revenue act does not permit corporations to file returns. Yet we all know that where a business unit is conducted through two or more corporations it is the consolidated net income that is the true net income for that business. The loss of one corporation in the

group must necessarily be offset against the profit of another before true income is arrived at. For many years our income-tax laws did in fact recognize this truth and permitted the filing of consolidated returns by affiliated companies. But, when our Government's fiscal needs began to overshadow the element of equity and fairness in our tax laws, the consolidated return was thrown overboard. Such an inequity may be bearable under an arrangement where a corporation is subjected to an income tax of from 12½ percent to 15 percent as is now the case, but it will certainly be intolerable under any such plan as would tax retained corporate income at rates running up as high as 73.9 percent.

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

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

Permit me also to direct your attention to section 27, subdivision (j) of the proposed law on the subject of intercorporate dividends. This provides that corporations, 80 percent or more of whose gross income is derived from dividends, shall, in figuring their undistributed-profits tax, be deprived of so much of the dividend credit as is equal to the amount of income accruing to a corporate shareholder owning 50 percent or more of the taxpayer's stock. In effect, what this means is that even if such a company distributes every dollar of its income, it may nevertheless have to pay 42½ percent of its income in undistributed-profits tax.

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

Presumably there are many instances in which the corporate structure can and should be simplified. Our laws in the past encouraged such complicated structures. On the other hand, there must be numerous instances in which corporate structures of this nature are necessary and invaluable in the conduct of large businesses. This is certainly true where business operations extend into many States and are thus subject to many State laws.

Senator KING. And where it extends into other countries, such as Chile and Mexico, where you cannot conduct business there as an American corporation, you have to organize a Chilean corporation and place all of your stock with the Government before you can get a charter, and you must organize a corporation in Mexico and place your stock there; so that if you and I should organize a company here, such as a mining company, and decide to branch out into Mexico and Chile, we would have to organize a company in Chile and another in Mexico; we would be the holding company, and Mexico and Chile would tax very heavily, and any dividends that would come back to the holding company, I was wondering whether there would be anything left.

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

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

Mr. SEIDMAN. Of course.

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

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

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

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

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

Thank you, gentlemen.

The CHAIRMAN. This is not the first time you have appeared before the committee in connection with tax laws, is it, Mr. Seidman?

Mr. SEIDMAN. No, Mr. Chairman; it has been my pleasure to appear here time and again.

The CHAIRMAN. Have you ever appeared before us when a tax bill was under consideration and advocated its passage?

Mr. SEIDMAN. I did not get your question, Mr. Chairman.

The CHAIRMAN. I thought your language today seemed very much like the language you have spoken before the committee when we have had other tax bills up for consideration, and I asked the question whether you have ever appeared and asked for the passage of any tax bill.

Mr. SEIDMAN. I have always tried to make constructive suggestions.

Senator BLACK. Have you ever favored any tax bill proposed here?

Mr. SEIDMAN. The New York Board of Trade—

Senator BLACK. Which one have you favored?

Mr. SEIDMAN. The New York Board of Trade has always favored a sales tax. The New York Board of Trade is for a sales tax as a means of raising revenue.

Senator BLACK. You have appeared here for how many years in connection with tax bills?

Mr. SEIDMAN. Fifteen years, at least.

Senator BLACK. Have you ever favored any bill that was proposed, and, if so, which one?

Mr. SEIDMAN. Whenever I appeared as an individual I was definitely for or against—

Senator BLACK. Have you ever appeared as an individual?

Mr. SEIDMAN. Yes, sir; perhaps as far back as 1921, in connection with the 1921 Revenue Act.

Senator BLACK. Did you favor that act?

Mr. SEIDMAN. I favored—there was a question there—

Senator BLACK. Is that one you favored?

Mr. SEIDMAN. There were many provisions that I favored.

Senator BLACK. Has there ever been a bill on which you came down here and testified in favor of; I would like to know that so that I could read the evidence.

Mr. SEIDMAN. Mr. Senator, no bill is ever presented in such form that you can favor all of it or none of it; there are provisions you are either for or against. This bill, itself, I have not criticized—

Senator BLACK. Are you in favor of the repeal of the excess-profits tax?

Mr. SEIDMAN. Yes, sir.

Senator BLACK. Were you opposed to the amendment which the Senate and House passed which attempted to plug up the loopholes?

Mr. SEIDMAN. I was in favor of it. I appeared for the New York Board of Trade—

Senator BLACK. Where did you testify in favor of it?

Mr. SEIDMAN. Four or five years ago.

Senator BLACK. Four or five years ago—you were here in 1934?

Mr. SEIDMAN. The 1932 was the Revenue Act which attempted to button up loopholes.

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

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

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

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

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

Mr. SEIDMAN. Yes.

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

Mr. SEIDMAN. Yes, sir.

Senator BLACK. You think it takes more time?

Mr. SEIDMAN. Yes, sir.

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

Mr. SEIDMAN. No, sir.

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

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

Mr. SEIDMAN. I would appreciate reading it.

Senator BLACK. I am sure you will enjoy it.

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

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

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

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

Mr. SEIDMAN. Yes, sir.

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

Mr. SEIDMAN. Contributors to what?

Senator BLACK. To the New York Board of Trade.

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

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

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

Senator BLACK. What large companies?

Mr. SEIDMAN. The small companies predominate.

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

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

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

Mr. SEIDMAN. Yes, sir.

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

Mr. SEIDMAN. Yes, sir.

Senator BLACK. The Chase National Bank?

Mr. SEIDMAN. I believe it does.

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

Mr. SEIDMAN. I do not think so.

Senator BLACK. You do not think so?

Mr. SEIDMAN. No, sir.

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

Mr. SEIDMAN. Quite likely.

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

Mr. SEIDMAN. I do not.

Senator BLACK. Does your firm do work for them?

Mr. SEIDMAN. My firm does not.

Senator BLACK. Is it engaged in independent accounting?

Mr. SEIDMAN. Yes, sir.

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

Mr. SEIDMAN. That is correct.

Senator BLACK. In each instance?

Mr. SEIDMAN. Yes.

Senator BLACK. And you appear voluntarily as a citizen?

Mr. SEIDMAN. That is right.

Senator BLACK. What is the name of your company?

Mr. SEIDMAN. Seidman & Seidman, certified accountants.

Senator BLACK. Where is its office?

Mr. SEIDMAN. New York City, head office.

Senator BLACK. At what place?

Mr. SEIDMAN. New York City.

Senator BLACK. What place in New York City?

Mr. SEIDMAN. The street number?

Senator BLACK. Yes.

Mr. SEIDMAN. 80 Broad Street.

Senator BLACK. Is that an office building?

Mr. SEIDMAN. Yes.

Senator BLACK. What?

Mr. SEIDMAN. The Maritime Exchange Building.

Senator BLACK. What is the number?

Mr. SEIDMAN. 80 Broad Street.

Senator BLACK. What is the number of the office?

Mr. SEIDMAN. The room number?

Senator BLACK. Yes.

Mr. SEIDMAN. Two thousand six hundred.

Senator BLACK. And who else is in your firm?

Mr. SEIDMAN. Just three brothers.

Senator BLACK. Three brothers?

Mr. SEIDMAN. Yes.

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

Mr. SEIDMAN. No, sir.

Senator BLACK. You took no part in it?

Mr. SEIDMAN. No, sir.

Senator BLACK. Have you appeared in connection with any other legislation except tax legislation?

Mr. SEIDMAN. No, sir; only tax legislation.

Senator BLACK. You have appeared on that ever since 1921?

Mr. SEIDMAN. Yes, sir.

Senator BLACK. And that was the first time?

Mr. SEIDMAN. I believe so.

Senator BLACK. You have appeared at each session since then?

Mr. SEIDMAN. Yes.

Senator BLACK. And that has been wholly on your own accord and nobody has asked you to do it?

Mr. SEIDMAN. Of course, what I have discussed here is the work of the committee on taxation of the New York Board of Trade, passed upon by the executive committee.

Senator BLACK. Who else is on that committee?

Mr. SEIDMAN. Well, there is Mr. Eggleston, of Young & Co., New York.

Senator BLACK. What business are they in?

Mr. SEIDMAN. Art dealers.

Senator BLACK. Who else?

Mr. SEIDMAN. Mr. James Rowe, a retired businessman; Mr. George Seamon, of the Hayden Chemical Co.; and three or four others.

Senator BLACK. Do you know the others?

Mr. SEIDMAN. Mr. Griffith, an officer of the New York Board of Trade; Mr. Blair, of the Chemical Bank.

Senator BLACK. The Chemical Bank & Trust Co.?

Mr. SEIDMAN. Of New York. I believe that is about all; there are six or seven.

Senator BLACK. You do not remember any others?

Mr. SEIDMAN. There may be one or two others.

Senator BLACK. But you do not remember them?

Mr. SEIDMAN. No.

The CHAIRMAN. Is Mr. Gilman a member?

Mr. SEIDMAN. No, sir.

The CHAIRMAN. Is Mr. Gimble?

Mr. SEIDMAN. No, sir.

The CHAIRMAN. Are Gimble Bros. members of the board of trade?

Mr. SEIDMAN. I believe they are.

The CHAIRMAN. Did you read the statement of Mr. Gimble in the papers this morning?

Mr. SEIDMAN. No, sir.

The CHAIRMAN. You should read it; it is a good statement.

Senator BARSLEY. Do you favor the sales tax as a substitute for all income tax?

Mr. SEIDMAN. No, sir; as a supplement.

The CHAIRMAN. The committee will recess until 2 o'clock.

(Whereupon, at 1:05, the committee took a recess until 2 p. m.)

AFTERNOON SESSION

The committee reconvened at 2 p. m., pursuant to the taking of the recess.

The CHAIRMAN. The committee will please come to order. Mr. Klein, I believe, is to be the next witness. Mr. Springer, do you have a word to say?

Mr. SPRINGER. Mr. Chairman, for the purpose of the record, my name is Durand W. Springer, secretary of the American Society of Certified Public Accountants, and in presenting Dr. Klein as our representative I want to say for the benefit of you who may not know it that at one time he was the tax editor of the New York Globe and professor of taxation in the City College of New York, an author of a very much read book on income taxation.

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

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

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

Dr. Klein will now make his statement to you.

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

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

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

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

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

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

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

One other matter regarding the simplicity I think I ought to touch upon: I think the bill has been unfairly criticized after a superficial reading of it, because of the presence of four tables, and refer-

ence in schedule B to the use of those tables, for corporations with incomes between 10 and 40 thousand dollars per year.

Table 1 and table 2, as distinguished from table 1-A and 2-A, are utterly and totally useless and redundant, impractical of application, and unnecessary. Firmly I believe if those two tables were eliminated the bill would not appear to be as formidable and foreboding as it now appears to be.

The CHAIRMAN. I made a statement calling on the experts to see whether or not they could work out something in the way of eliminating some of those tables and put it in one, if possible.

Dr. KLEIN. Some of the suggestions I will make ought to be of help to those experts, and I want to tell you there are some very commendable features in the bill, and perhaps I may list them quickly.

Little has been said by outsiders, and probably little will be said in favor of the bill, and I want to go on record about seven points which I think are highly commendable.

First. The proposal to levy a flat tax on selected corporations, while I might not agree with you on those which should be selected, and especially on receivers and deficit corporations, is a move in the right direction.

Second. I commend in principle the provisions, which though I think are entirely too complicated, which are intended to lighten the tax burden on corporations with prior deficits, those prohibited by binding agreement with creditors or by statute from disbursing earnings, and debt-ridden corporation which wished voluntarily to amortize their debts.

Third. Early elimination of the capital-stock and excess-profits taxes, although I raise the question whether you can afford to give up those revenues.

Fourth. Subjecting dividends to surtaxes. I think is a move in the right direction, although on the basis of equity it seems to me there should be an equivalent exemption for the recipient of the dividend in taxing him before the dividend is made possible. I sometimes think that theory, which seems to be held by most, does not bear theoretical analysis.

Fifth. You have a dividend carry-over provision, and I think if you do finally decide to levy high rates, you ought to consider the fairness and the need of having some carry-over provision for net losses similar to that which was introduced in the 1918 act, carried through into 1921 and gradually sloughed off.

6. You have a very commendable feature with respect to the complete liquidation of corporations, and by that device or provision you make unnecessary the resort to subterfuge, and I should like you to consider the advisability of extending that into the next logical realm, partial liquidation.

7. With respect to your withholding provisions, the attempt to tax those nonresident aliens that to so great an extent escape taxation, I would suggest a flat 15-percent rate, instead of 10 percent, and I would also suggest in addition to your own provisions the ones you are not considering, a tax on profits resulting from the sale of securities.

A tremendous volume of securities are actively dealt in by nonresident alien individuals and corporations. The Securities Ex-

change Commission can give you those figures if you are interested in them.

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

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

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

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

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

The CHAIRMAN. Doctor, are you a lawyer?

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

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

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

But, I say to you, just suppose by the barest, the wildest possibility that this bill turns out in its major part to be unconstitutional; what is the result? You have given up \$1,230,000,000 on computed income under existing levies, subject to the wildest sort of adjustment by the statisticians I suppose, when they get down with their pencils to figure it, for something supposed to result in \$620,000,000 additional revenue.

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

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

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

As the President first announced the theory, I think it sounded a responsive chord in the minds of many who publicly claim to be

opposed to anything that emanates from the White House today, but the Ways and Means Committee found, as you will note, that you cannot apply that principle as is without modification, without adjustment, without special consideration, which accounts for the turn to the actual complexity of the bill.

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

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

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

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

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

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

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

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

Under existing section 351, as you know, corporations, personal holding companies which fail to distribute at least 80 percent of their net income, slightly adjusted, are subject to the tax that runs from 20 to 60 percent. Extend that, if you will, to the corporations that seem to you to be in mind, when you refer to a handful of individuals able to control the destinies of the corporation to their own tax enrichment.

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

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

Section 102 of the present law deals, as you know, with mere holding companies and mere investment companies, and with a great category of other corporations which permit accumulation of earnings unreasonable in size. I doubt very much whether the ingenuity of the present administration officials, and that splendid body of technicians who carry on the Treasury Department, when the officials

come and go, cannot put teeth into sections 351 and 102. I would hate to admit their inability in that direction.

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

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

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

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

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

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

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

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

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

Senator KING. Net income, you mean?

Dr. KLEIN. Ordinary income as defined in the existing law, deduction to be allowed for capital losses, both securities and capital assets, but in no event to increase the taxable income by more than 15 percent. That would mean that the 20 percent might drop to 17 percent, but not beyond that.

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

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

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

The companies in bankruptcy, and those in other forms of court reorganization proceedings, I should think that a 10-percent tax, although I do not think it makes much difference in the long run

whether you say 10 or 20, you will not collect much there, but it looks well, I think, to limit to about 10 percent.

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

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

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

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

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

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

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

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

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

Suppose you were to permit as a deduction from that same net-income figure to a very limited extent, and at the present time I suggest not more than 2 fiscal years, of 50 percent of the amount distributed in the first year, and limited so far as reduction of taxes is concerned to 20 percent thereof, or one-fifth, which would be 4 percent; and for the next year also to 20 percent, but this time only with respect to 30 percent, for what is actually spent—not contracted for, but actually spent—by way of replacement and additions to plant and equipment.

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

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

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

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

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

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

Dr. KLEIN. It brought it about, I believe, so we are told.

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

Dr. KLEIN. I am not sure, but I think Senator King's reference to the French Revolution is correct. Let me give you the figure. A tax on salt at 1 cent per pound would be \$152,241,480, on the basis of the consumption of 1934. I am not surprised that you are surprised at such a figure.

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

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

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

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

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

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

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

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

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

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

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

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

The CHAIRMAN. Why wouldn't Senator Hastings be interested in it?

Dr. KLEIN. I will make that clear, in the hearings on the 1935 act, and I go by the record now, Senator Hastings refreshed the recollections of his colleagues by referring to the fact that when the so-called utility death bill was under consideration he or somebody else had stated that if you are going to compel the break up of these pyramided structures—and I hold no brief for them; they are abominations in many respects—that there ought to be some tax easing out of the situation, and, as I recall, it was in the Senate, and not on the other side of the Capitol, that section 110 (h) was introduced, amending section 112 of the 1934 act, which permitted, as I recall it, a tax-free break-up for the liquidation if consummated within a 5-year period.

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

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

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

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

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

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

The CHAIRMAN. All of our draftsmen, and they are taking down notes.

Dr. KLEIN. I am sure of that. Here is something for which my society is not responsible, but you may welcome it, and on this I think the Treasury as well as you will admit that as your tax burden becomes more onerous there is a great conflict between the taxgatherer and the potential taxpayer, and that accounts in some manner, if not entirely, for the large number of American-owned foreign corporations. I have not the statistics on this, and nobody really has, but they do business without paying any tax on their profits except to the extent it is American business and it is discovered, and, strange as it may seem, upon the death of the stockholders in such corporation,

you wipe the slate clean, and all of that increment of income escapes taxation.

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

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

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

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

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

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

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

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

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

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

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

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

Dr. KLEIN. Yes; but they would like to sell more. You cannot get me to argue about Texas, because I have a soft spot for that State.

Senator BLACK. I understood you to say that Texas got more than New York and I wanted to know whether New York got anything in the way of profit on the things produced and sold in Texas.

Dr. KLEIN. Yes; but I think it is more or less a geographical question.

Senator BLACK. You think it is geographical?

Dr. KLEIN. Sir, you have got me all wrong; I am really praising Texas.

Senator CONNALLY. In New York you regard Texas as one of the richest suburbs of New York City.

Dr. KLEIN. Not for plucking, if that is what you mean.

Senator CONNALLY. You have plucked them so bad that there is not much left now.

Dr. KLEIN. You cannot get me to argue about Texas because as I said I have a soft spot for that State. I am through now in a few seconds except for your questions, if you have any to ask.

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

The CHAIRMAN. Thank you very much, Mr. Klein. Your discussion has been very instructive, and we will have included in the record at this point the brief submitted by you.

(The brief referred to is as follows:)

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

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

The revenue bill under discussion deals with a number of matters, but I intend to restrict my remarks to the income-tax features. What I am about to submit represents my views as chairman of the committee on Federal legislation of the American Society of Certified Public Accountants, views which, in the main, except where otherwise indicated or implied, are shared by the board of directors and by my fellow committeemen.

Besides criticism of selected provisions of the bill, specific and detailed constructive suggestions are offered and, in addition, there are presented for consideration specific as well as general changes and modifications and a fundamentally different approach to immediate as well as long-range revenue-law revision. All of this is arranged in 15 sections.

Respectfully submitted,

JOSEPH J. KLEIN,
Chairman, Committee on Federal Legislation, the
American Society of Certified Public Accountants.

Committee on Federal legislation—Howard C. Beck, Washington, D. C.; Howard S. Bell, Spokane, Wash.; Gilbert F. Dukes, Mobile, Ala.; James J. Fox, Boston, Mass.; Elsworth L. Fulk, Lincoln, Nebr.; Gilbert R. Geiger, Peoria, Ill.; John S. Glenn, Nashville, Tenn.; Horace P. Griffith, Philadelphia, Pa.; James E. Hammond, San Francisco, Calif.; John T. Madden, New York, N. Y.; Douglas S. Meaden, Cleveland, Ohio; Allen Redeker, Denver, Colo.; Frank A. Shallenberger, Baltimore, Md.; T. Dwight Williams, Oklahoma City, Okla.

Executive committee—William D. Morrison, Denver, Colo.; Harry M. Jay, Memphis, Tenn.; Durand W. Springer, Washington, D. C.; William C. Heaton, Elizabeth, N. J.; Henry J. Miller, New Orleans, La.

1. ALLEGED SIMPLICITY OF THE REVENUE BILL

The President, in his message to the Congress on March 3, 1936, indicated additional revenue needs. He invited the attention of Congress to the revenue-raising possibilities of a tax on undistributed corporate income. He said of this proposal:

"Such a revision of our corporate taxes would effect great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the Nation. It would constitute distinct progress in tax reform."

As a representative of the American Society of Certified Public Accountants, I am not here to discuss tax reform per se, nor whether or not the proposal constitutes real or desirable reform. I do, however, refer to the experience of the Committee on Ways and Means in its attempt to apply the apparently simple principle advocated by the administration and submit, as a representative of a group which has been familiar with principles and practices of Federal income taxation since 1909, and which has been privileged to serve both the Government and the taxpayer, that the precise proposal now under consideration by the House and by this committee is decidedly not simple.

Competent students of taxation were shocked at a first reading of the bill. In my own experience with American and foreign taxation and with national and local taxation, I know of no taxing measure that approaches the present bill in apparent as well as in actual complexity. In my opinion, the present bill cannot be made really simple. I venture the guess that if the country were ever unfortunate enough to be subjected to taxation under any such bill, as the one under consideration, whether or not the proposed "windfall tax" provision therein contained would prove fruitful of revenue, accountants and tax practitioners would find in the legislation a veritable windfall, for I doubt very much that many corporations, unless served by professional accountants and tax experts, would risk undertaking to determine the tax under the terms of the bill.

I should be the first to concede that the message of the President, in its reference to a tax on undistributed corporate income, was set forth in simple and understandable terms. The members of this committee are aware, however, through wide experience in the drafting of revenue legislation, that a precise and detailed tax measure, capable of wise, equitable, and effective administration throughout the land and under the diverse conditions and situations which exist, cannot be brief and simple if it is to avoid unintended hardship and harsh discrimination. Although we have become accustomed to complex revenue laws, all our past experience has not prepared us for what is now proposed as a substitute for existing law. But it is hardly necessary to labor the point. A few valiant voices on the other side of the Capitol have publicly acclaimed the bill under discussion as simple in composition and easy of application. I shall leave to others, less mild-mannered than the speaker, just characterization of the assertion.

There comes to mind the procedure of the College of Cardinals when a new pope is to be elected. It would be cruel and inhuman punishment to test the alleged simplicity of the proposal by inviting Congressmen who voted for the bill to apply the rate formulas to typical problems. If these Congressmen were placed in solitary confinement and deprived of food and drink until they had solved successfully one of several typical problems which I am prepared to submit, it is a safe guess that they would never again legislate on this earth.

II. A GENERAL SUBJECT, WITH SPECIAL REFERENCE TO COMMENDABLE FEATURES OF THE BILL.

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

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

1. A flat 15-percent tax (in lieu of the complicated levies under sec. 43) on selected corporations such as banks, insurance companies, foreign corporations not doing business in the United States, and, most especially, companies in receivership and "defect" corporations.

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

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

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

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

6. Liberalization of provision dealing with the tax incident to complete liquidation; the provision should be extended to the two types of partial liquidation.

7. Extension of withholding provisions to cover dividend payment. (For myself, I suggest a flat rate of 15 percent (instead of 10 percent proposed for individuals) on income of nonresident alien individuals, corporations, partnerships, and other entities, without business activity in the United States.)

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

III. SOUND LIMITATION ON REVENUE INCREASE

While it is realized that current expenditures of the Government should be met currently, and while no competent person would advocate the meeting of operating expenses by increased deficits, at the very threshold of our inquiry as to the amount of additional revenue required, we are struck by the absence of any reference to curtailment of expenditures. Accountants have had considerable budgetary experience. In this field they have assisted governments and private industry. In their own recent domestic economy, they have also been confronted with the problem of budget balancing. Professional accountants would be chargeable with gross negligence if, in dealing with budgetary problems, they did not study and examine the disbursement phase of the budget. Accountants viewing the amount of increased taxes sought to be raised by the bill cannot withhold comment that it is lamentable that there is no evidence whatsoever that any attempt has been made to minimize the need of increased taxation through curtailment of expenditures. Although it is undesirable that the invalidation of the processing taxes and the acceleration of the bonus payment unbalanced the ordinary budget, it is submitted that Congress should endeavor to reduce current revenue needs, as far as is possible, by reduction of expenditures, and restrict additional taxes to make good that portion of the precipitated deficit which cannot be met by elimination and reduction of expenditures. Such additional taxes should be temporary levies and should not be made a part of our permanent tax system.

IV. ALLEGED JUSTIFICATION FOR INCREASING CORPORATE TAXES

Among the reasons which I have heard advanced in justification of the proposed tax on undistributed corporate net income was one which has a popular appeal. It is that, aside from the question of additional revenue needs, the

advantages and privileges of corporations, as compared with partnerships and sole proprietorships, amply justify a heavier tax; also, that, in the past, corporations have enjoyed tax benefits denied to partnerships and sole proprietorships. Let us look at the record:

From 1900 to 1913, corporations were subject to a Federal excise tax, although it was not until 1913 that individuals became subject to income tax. During 1913, corporations were subject to a combined income tax and excess-profits tax which attached a maximum of 82.4 percent; the corresponding maximum tax applicable to individuals was 77 percent. However, dividends distributed by corporations (which, as stated, might have paid a maximum of 82.4 percent) became subject to surtax in the hands of recipient stockholders up to a maximum of 45 percent, or to a combined tax of 33.84 percent. Corporations were also, of course, subject to Federal and State taxes on capital. During later years, the tax on individuals, relative to that on corporations, became higher, so that it is true that in many instances there was, and still is, tax economy in conducting business as a corporation. There is economic justification for some differentiation, because a stockholder of a corporation does not actually enjoy corporate profits until they are made available to him, as was recognized by the Supreme Court in *Blauer v. Muesel* (252 U. S. 189). However, merely from the viewpoint of Federal, State, and local taxation, advantages no longer exist in favor of conducting small enterprises in corporate form.

V. CONSTITUTIONALITY OF THE REVENUE BILL

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

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

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

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

The existing levies on corporate income are as follows:

1. The ordinary income tax, ranging from 12½ percent to 15 percent (prior thereto at 13½ percent), which, together with the tax on a consolidated income basis, and the surtax under sections 102 and 351, yielded \$572,117,870 during the last complete fiscal year which ended June 30, 1935, and collections under which during the present fiscal year have been \$125,275,022 greater than during the corresponding 9 months of the preceding year.

2. The capital-stock tax at the rate of \$1.40 per \$1,000 of declared valuation which, at the \$1 rate imposed under the 1934 act, yielded \$91,508,121 during the last complete fiscal year which ended June 30, 1935. Collections at the higher

rate during the first 9 months of the current fiscal year have been \$85,589,876, an increase of \$1,125,172 over the corresponding period of 1935.

5. The excess-profits tax at 8 percent and 12 percent on income in excess of the amounts freed from the levy because of the capital-stock tax which, at the present rate then in effect, yielded \$6,560,483 during the last complete fiscal year ended June 30, 1935. \$10,000,000 was the estimated yield for the current fiscal year, per the 1935 report of the Secretary of the Treasury.

4. The surtax under section 192 for unreasonable or improper accumulation of surplus, at 25 percent and at 35 percent, and the surtax on "personal holding companies" under section 351, at rates ranging from 20 to 60 percent. The yield from these sources has not, so far as I know, been published separately, but it is undoubtedly available to the committee, as it is the estimate for the current year. This levy is retained in a limited form, as is also the surtax on "personal holding companies."

The total yield from all taxes on corporations for the last fiscal year which ended June 30, 1935, was \$670,196,480; collections for the current year are running ahead of those for last year by approximately \$131,600,000. (If business continues to improve, it is reasonable to expect correspondingly higher yields from the sources under discussion. Indeed, the Statistician of the Treasury has estimated that all corporate taxes for 1936, if the existing law remains unchanged, would amount to \$1,132,000,000.)

In considering the revenue bill, consideration must, of course, be given to the proposal that, save for the temporary retention of the capital-stock tax at half the existing rates and the temporary retention of the excess-profits tax, reasonably assured income of over \$1,000,000,000 is to be abandoned, in the belief that the complicated and novel measure under discussion will yield a permanently increased revenue of \$620,000,000 per annum from the proposed levies on undistributed corporate income and from the proposed increased income tax on dividends received by individuals, which are to become subject to the normal as well as to the surtax. Fellow accountants with whom I have recently discussed the matter, while hesitating to criticize official estimates, agree with me that it is quite impossible to exaggerate the unavoidable hazards of relying on estimates of yield from so novel a measure as the pending revenue bill.

Suppose, just suppose, that the Supreme Court were to decide that the new tax law is unconstitutional. Personally, I shall not argue with anyone who claims that the risk of such a decision is immeasurably slight, nor do I suppose that anyone of competence would unqualifiedly assert that under no circumstances is it conceivable that the High Court might find the proposed bill, in its major provisions, invalid. Whether the Schechter (N. R. A.) and the Trade A (Hoosier) decisions were or were not catastrophic in their effect is quite beside the point; a final decision holding unconstitutional the proposed levy on corporations would work unthinkable injury to our national finances.

To me it seems abundantly clear that those who are charged with the responsibility of revenue raising would not early assume the constitutional risks inherent in the proposition. Fortunately, as I shall at once proceed to show, it is entirely unnecessary to assume such risks.

VII. A SHORT-SIGHTED FISCAL POLICY

Witnesses before the Ways and Means Committee have clearly indicated that the fiscal policy of corporations which resulted in the creation of surpluses during profitable years alone made possible dividend disbursements during lean years. In the teaching of economics and corporate finance, the principle of profit conservation for dividend-stabilization purposes has long been regarded as sound doctrine.

Recently, the National City Bank of New York, on the basis of Treasury statistics, showed that during the period from 1921 to 1933, while the average annual reported net income for all corporations amounted to \$3,200,000,000, dividend disbursements during the same period averaged, \$3,900,000,000 per annum. More significant was the showing that during 5 of these 13 years dividends were distributed, either in the absence of net income or in amounts substantially in excess of net income. Thus, during 1930, the first full year of the depression, dividends aggregating \$5,600,000,000 were paid by corporations which, during that period, reported net earnings of only \$1,400,000,000. In that year, for example, the corporate income tax rate was 12 percent; without

adjustment for the deficits of corporations which were taken into account in the determination of the aggregate net income, and on the assumption that the conclusions predicated on the statistical data employed do not require substantial adjustment, the Treasury would have foregone collections of over \$108,000,000 had no tax been levied, as is proposed in the revenue bill, on corporations which had distributed all of their corporate earnings. At best, to waive taxes of corporations which distribute all of their current income manifestly would exempt from tax, during certain lean periods, many large companies with substantial income; to reduce the tax of dividend-paying corporations proportionately to the ratio of dividends paid to net income would similarly benefit many companies amply able to meet tax obligations.

Moreover, if Congress is to embark on the policy of taxing current corporate income on the basis of the amount retained, it should be clear that while temporary collections will be greater, during periods of business recession three evils will be superimposed on those which are inevitably associated with depressions: (a) The amounts distributed by corporations will be less because their reserves will be low; (b) dividends received will be less, the tax on these dividends will be less, and stockholders will have less to spend when spending is most necessary; (c) those corporations which are conducted profitably despite the business recession (and there are some) will pay no tax on their profits at a time when the Government needs income most, because of the probability that these corporations will distribute most, if not all, of their earnings.

An analysis of the normal probable effect of the proposed bill appears to justify the conclusion that it embodies a short-sighted fiscal policy—a policy which attempts to collect in taxes more than the traffic will bear, without concern for the fiscal needs of the morrow. Legislation so conceived lacks the essential qualities of statesmanship and is without vision.

VIII. INFLUENCE ON CORPORATE FINANCING AND GROWTH

If the present bill represents a permanent attitude of Congress toward corporate taxpayers, financing through bond issues will inevitably be discouraged, because it will become increasingly difficult to assure bondholders of the established mode of protection to which they are entitled. Provision restricting dividends so long as bonded obligations exist, and adoption of a policy of amortization (thus interfering with the free use of earnings for dividends on common and preferred stock) will be hindered because of the penalty on retention of earnings. And as one regards this problem one cannot be unmindful of the history of taxation here and elsewhere. A tax tends to become crystallized; the temptation to increase rates becomes irresistible; hence, whatever the evils in the proposed bill may be, such evils tend to become greater as the needs for increased revenue arise. It is for this reason, among others, that constructive criticism of the measure should be free and unrestricted.

Now, as to the growth of corporations. It is almost too manifest for argument that corporations which, in the past, have built up large surpluses will, through the inevitable effect of the tax policy incorporated in the bill, be tremendously advantaged in competition with corporations that have no surpluses or deficits and with newly created enterprises. Surely, the framers of the revenue bill could not have intended any such boon to the opulent corporation.

IX. SAFER EXPERIMENTATION

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

(A) *Extension of existing sections 102 and 351.*—Under section 351 of the existing law, a surtax is levied on incomes of personal holding companies. This is in addition to the normal tax on the statutory net income of such corporations, levied at the rates applicable to ordinary corporations. The statutory net income is adjusted in the manner clearly set forth in the law, and the excess of such adjusted net income over dividends paid during the taxable year and after a 20-percent reserve and a reasonable reserve to retire indebtedness incurred prior to 1934 is subject to a graded surtax ranging from 20 percent to 60 percent.

To the extent of the validity of the criticism directed against corporate management, namely that because a few stockholders are in control, income is permitted to accumulate unreasonably and unnecessarily, the definition of personal holding company could probably be modified so as to cope with major abuses. Surely, if the criticism is predicated on the conduct of a relatively few corporations which are controlled by a handful of stockholders, that fact hardly justifies such radical change in our taxing system as is contemplated in the revenue bill.

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

(B) *Continuation of existing taxes supplemented by a minor (experimental) tax on undistributed corporate income.*—If it is to be assumed that Congress is determined to experiment with a tax on retained corporate earnings, I suggest that the existing corporate levies be continued; that if other alternatives are not acceptable, a flat corporate income-tax rate be imposed slightly higher than the existing maximum graded rates; that the normal tax be made applicable to dividends received by individuals; that the normal tax on individuals be increased by one or at most by 2 percent, or that the specific exemptions be moderately reduced; and, in addition, that a very moderate, simple, and experimental tax be imposed on undistributed corporate income.

I suggest for discussion a tax of 1 percent on the first 10 percent of retained net income (determined by deducting from ordinary net income the applicable income tax thereon, capital losses not deductible in calculating ordinary net income, and taxable dividends disbursed during the dividend year), 2 percent on the next 10 percent with similar gradations until a maximum of 10 percent on the final 10 percent of retained net income has been reached.

There may be some question as to the constitutionality of any levy on retained net income because it is neither on gross income nor on true net income, but the chances are that such a tax levied on corporate taxpayers would survive the constitutional test. But even if the levy were eventually held unconstitutional, no great harm would ensue. On the other hand, if the levy were found to be constitutional, Congress could safely, if it so decided, later embark on a wider and more comprehensive plan of taxing undistributed net income.

X. SIMPLIFICATION OF THE REVENUE BILL

If Congress is determined on enacting a general tax on undistributed net income of corporations, simplification of the revenue bill should be sought, even at the expense of theoretical (but never completely attainable) equitableness. Why, for instance, should Congress wish to avoid "income brackets" for corporations and retain them with respect to individuals? Insofar as the revenue bill undertakes to tax ordinary business corporations, it is primarily on the basis of the retained net income, a concept which is quite different from taxable net income as it has developed under the present series of income-tax laws. That concept, however, is the basis of the surtax under sections 102 and 351. Perhaps the basis for acceptable compromise may be found in the following relatively simple tentative proposals in which the suggested tax on retained net income is based on net income and specified deductions therefrom:

(1) Applicable to ordinary corporations without special problems:
 (a) Deductions to be allowed for capital losses not taken into consideration in the determination of ordinary net income but in no event to decrease the ordinary net income by more than 15 percent thereof;

(b) Deductions also to be allowed for distribution of earnings taxable in the hands of individuals, limited, however, to one-third of the amount thereof, and in no event to decrease ordinary net income by more than 25 percent thereof.

If the maximum deductions are taken, the net tax will be equivalent to 12 percent of the ordinary net income; ordinary dividend distributions up to three-fourths of the amount of net earnings will be encouraged without unreasonable

hardness or questionable validity or undesirable economic consequences; and the yield from taxes on individuals will be increased. Under the provisions of the revenue bill, if 75 percent of current earnings are distributed, the tax on net earnings would be about 4 percent for ordinary corporations with incomes up to \$10,000 and 7 1/2 percent for such corporations with incomes over \$40,000; the corresponding tax herein proposed is 15 percent.

(2) Applicable to personal holding companies: Continue the surtax under existing section 351, with rates provided in existing section 104, and continue the existing normal tax on such corporations, or, preferably, substitute a flat tax rate.

(3) Applicable to mere investment or holding companies: Same as tax proposed for section 351 corporations above.

(4) Applicable to corporations in bankruptcy or in court reorganization proceedings: A tax of 10 percent on the ordinary net income.

(5) Applicable to corporations with statutory and/or binding legal restrictions on payment of dividends:

(a) A tax of 20 percent on ordinary net income.
 (b) Deductions to be allowed for capital losses not taken into consideration in the determination of ordinary net income, but in no event to decrease the ordinary net income by more than 15 percent thereof.

(c) Deductions also to be allowed (i) for distributions of earnings taxable in the hands of individuals, (ii) for the amount of current net earnings which, pursuant to statutory requirements, cannot be distributed as dividends; and (iii) for the amount of current net earnings which, pursuant to binding written agreements between the taxpayer and its creditors in existence on or before March 3, 1936, cannot be distributed as dividends; the aggregate deductions hereunder limited, however, to 50 percent of the aggregate amount thereof, and in no event to decrease ordinary net income by more than 25 percent thereof. The proposed provision for including among deductions item (ii) accomplishes part of the evident purposes of section 14 more simply; it is also more equitable.

XI. ENCOURAGEMENT OF CAPITAL DISBURSEMENTS

It is a trite observation that in the framing of a revenue measure economic conditions should, as far as possible, be taken into consideration. Many observers agree that the continuance of the existing economic derangement is due partially to the persistent volume of unemployment, and that unemployment is most severe and distressing in the so-called heavy or durable goods industries. In the endeavor of the administration to remedy this situation during the past 2 years, among the billions disbursed for direct and indirect relief, many millions have been spent to decrease unemployment in the heavy industries. Discounting adverse and unfriendly criticism and allowing for faulty labor statistics, it is nevertheless unfortunately true that improvement in these industries appears not to have been commensurate with the amount spent by Federal, State, and local governments. I am too well aware of how history manages to ignore prophecy, whether optimistic or pessimistic, to assert without the utmost qualification that, in my opinion, democratic government is in danger unless business and industry cope successfully with this problem of unemployment. The question then becomes: How, if at all, can taxation most effectively cooperate? I offer for the consideration of the committee a proposal that disbursements for replacement of, and additions to, plant and equipment be, to a very limited extent and during a relatively brief period of time, permitted to decrease tax liability. The effect should be in line with Government policy. My tentative suggestion, primarily for consideration and discussion, is as follows: That, applicable to the taxable year 1936, disbursements made (and not merely obligations incurred) for plant and equipment replacement and additions actually installed shall be allowed as a deduction from ordinary net income to the extent of 50 percent of the amount of the disbursements, but not in excess of 20 percent of the ordinary net income; that, applicable to the taxable year 1937, such disbursements shall be allowed as a deduction to the extent of 30 percent of the amount of the disbursement, but not to exceed 20 percent of ordinary net income. I trust that no similar provision will be necessary, desirable, or expedient for the taxable year 1938.

The suggested proposal under any given set of rates, under existing law or regardless of the type of new revenue legislation which may be enacted, would unquestionably result in decreased revenue; the estimated loss need not be provided for by increased basic tax rates or otherwise, because of the probability

that improved business and increased employment in the heavy-goods industries would result in increased corporate and individual taxable incomes, and because such prospectively increased employment would at least correspondingly reduce the Government's responsibility for emergency relief.

During the past 2 years, taxpayers have been permitted deductions for depreciation at substantially lower rates than those which were allowed theretofore. The tax effect of this policy, as administered under Treasury Decision 4422, which was promulgated on February 28, 1934, is indicated in the reports of the Commissioner of Internal Revenue for 1934 and 1935. From March 15 to July 15, 1934, a total of \$248,821,943 of claimed depreciation was disallowed, resulting in increased taxable income of \$242,424,222 and recommended deficiency assessments of \$29,689,304. For the full fiscal year 1935, the total disallowed for claimed depreciation deductions was estimated at \$288,061,928, the resultant additional tax at \$351,916,414, and the amount of such additional tax agreed to by taxpayers at \$25,682,112. The slower depreciation write-off has undoubtedly tended to delay plant replacement. When a capital account on the books has been nearly written off, replacement reserves are correspondingly large and management is not as prone to hesitate to make replacements as when machinery still in use appears on the books at a relatively greater value. This retardation in replacement has undoubtedly had some appreciable effect on increased unemployment in the capital-goods industries. The suggestion for temporary allowance of a limited part of the cost of replacement and additions is, in addition to the other reasons advanced, predicated on the existing depreciation allowance policy.

XII. FINANCING THE ACCELERATED BONUS

The President's message advised Congress that from \$120,000,000 to \$160,000,000 would be required annually for the next 9 years to amortize the cost of the recent bonus legislation; in the specific recommendation \$120,000,000 was the figure employed. Speaking in what follows for myself alone, I feel that it is a fair assumption that the bonus legislation was enacted because Congress believed that there was an overwhelming popular demand therefor. It is unthinkable that Congress should wish to have the electorate know exactly how and to what extent and by whom the burden of financing the cost of the bonus legislation is borne? If a direct tax is ever justified or expedient, the financing of popular legislation would seem to provide the occasion. For this reason, I invite your attention, without recommendation, to the desirability and expediency of having the cost of the recent bonus legislation borne by popular subscription, as it were.

In this connection, I direct your attention to the fiscal possibilities of a tax on salt. Production of salt in the United States, during 1934, amounted to 7,612,974 short tons; a tax of 1 cent per pound would be equivalent to \$132,241,480. Not all of the salt produced is of the table variety, of course, and the tax could be so calculated as to be equivalent to 1 cent per pound on the refined product, with the resulting tax somewhat less than the figure given. A salt tax, if levied at the point of origin, would not create substantial administrative problems because the number of domestic producers, per the statistical abstract for 1935, is less than 100.

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

Primarily for the purpose of reminding you of their tax potentialities, I shall also refer to three other commodities which, at least administratively, also lend themselves to simple levies.

The domestic consumption of sugar during 1935 is given as 6,832,510 short tons. Much of this sugar is imported. If a tax of 1 cent per pound could be levied at the import point and, with respect to the domestic product, at the refinery, the yield would approximate over \$130,000,000.

The import of coffee into the United States during 1935 amounted to 1,504,170,000 pounds. A tax of 5 cents per pound, administratively easy of collection as an import duty, would yield about \$75,000,000.

If coffee were subject to tax, tea should also be taxable. The import of tea during 1933 amounted to 35,705,000. A tax of 10 cents per pound would yield about \$3,570,500, while a tax of 20 cents per pound would yield about \$7,141,000.

XIII. TREATMENT OF INTERCOMPANY DIVIDENDS

In the 1935 act, by section 102 (h), 10 percent of dividends received by a corporation from a domestic corporation was made subject to the normal tax. In the same act, by section 110, the break-up of pyramided corporate structures was encouraged by permitting tax-free liquidations over a period of 5 years. In the bill under consideration, by section 27 (j) (4), intercompany dividends are subject to maximum taxes, even though the passage of the dividend to the parent unit is expedited and the top corporation makes immediate disbursement to its stockholders. Speaking for myself and not for my committee (which was not consulted about the matter), I feel that the inevitable result could not have been intended. Punitive taxes directed against corporations frequently hurt innocent stockholders. I believe that the minimum change should exempt from the application of the subsection (1) corporate groups which are in process of statutory liquidation under section 112 (b) (6) of the bill, and (2) group inter-company dividends which are distributed to others than controlling corporations during the "dividend year" in which received. These corporate groups should not be forced to seek lawful means of escape, such as is indicated, for example, in section 27 (j) (3) of the bill.

XIV. SPECIAL PROVISION FOR AMERICAN-OWNED FOREIGN PRIVATE CORPORATIONS

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

Something like analogous precedent for this suggestion may perhaps be found in section 110 of the 1935 act, which appears as section 112 (b) (6) in the revenue bill. This section, as all of you, especially Senator Sterling, will recall, was intended to encourage the break-up of the pyramided corporate structure recently under criticism. My suggestion is to encourage the dissolution of American-owned foreign private corporations. Two methods suggest themselves:

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

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

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

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

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

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

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

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

assured tax on nonresident aliens and corporations, a small unit tax on one or more commodities.

(3) That the Joint Congressional Committee on Taxation, or a special joint congressional committee, should be forthwith assigned to the task of studying our tax system and fiscal needs and to report its findings and recommendations by March 1, 1937.

The CHAIRMAN. The next witness listed is Mr. Satterlee, of New York City. I hear no response, and apparently he is not here.

Mr. Lane is the next witness.

STATEMENT OF E. H. LANE, THE LANE CO., INC., ALTA VISTA, VA.

The CHAIRMAN. Mr. Lane, you are from Virginia?

Mr. LANE. Yes, sir.

The CHAIRMAN. We will give you 20 minutes, Mr. Lane, and if you can get through in less time, we will appreciate it, but if you do not finish, if you will state your proposition, you may put your brief in the record.

Mr. LANE. Mr. Chairman, I guess that a businessman to come up here is taking a lot of nerve, because it seems that for the last few years it has been a sort of open season for businessmen.

We started a little business down in Virginia in 1912, and when this new tax bill was presented we began to visualize what that would have done if that had been in effect during the years of our business existence, not so much that it can go back and hurt us over those years but the fact is we have about 3,500 dealers in this country, a lot of whom have lost a good part of their working capital.

Senator BARKLEY. What is your business; you have not stated it?

Mr. LANE. I am a manufacturer of furniture, cedar chests and things of that kind.

Senator BARKLEY. Household furniture?

Mr. LANE. Yes, sir.

Senator CONNALLY. You are from Marion, Va.?

Mr. LANE. Alta Vista, Va., a small town near Lynchburg. Of these dealers we sell to, they are of varying credit, first-grade credit, who discount their bills and all such things; the second-grade credit, which is a lesser grade, and the third-grade credit, which means credit of almost any kind.

A lot of them have lost their working capital during the depression. If I was speaking from my own point of view, I would say go ahead and pass the law for the reason we have sufficient capital in our business. We have a lot of competitors who have lost their capital during the depression, and it would be that much easier for us to stay in the industry, because we can get capital from the capital market, but we have competitors that cannot get it, and they would not require enough capital to interest the general market.

We have about 1,500 dealers who we are afraid of going broke because they were so impaired in the last depression. I will say our capital position has been impaired somewhat in the last depression, and we are worried over that, because if our dealers go broke, they will pull us down.

I have tried to prepare a little picture of what will happen to our business if this proposed tax law had been in effect during our period in business, and I can give that in a brief form, or go into detail.

The CHAIRMAN. Just give us a brief statement of it.

Senator BLACK. Is your business incorporated, or a partnership?

Mr. LANE. It is incorporated, a close corporation, with only about 75 stockholders.

Senator BARKLEY. What is the capital stock?

Mr. LANE. We have 10,000 shares no par-value stock, and our present capital is about a million dollars.

We started with a capital in the beginning of \$18,000 and we added to it from time to time, until it got to about \$189,000.

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

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

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

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

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

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

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

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

Senator HASTINGS. During the first 7 years?

Mr. LANE. Yes, sir.

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

Mr. LANE. Yes; and paid out approximately 10 percent of that, or some \$3,000.

Senator HASTINGS. For what?

Mr. LANE. For dividends, and we paid out approximately the same amount in taxes, to be exact, \$2,937 paid in taxes during that period. Under this new bill, we would have had to pay \$12,500 or 35.7 percent of all of our earnings in that time.

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

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

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

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

Senator BARKLEY. Your figures are before or after you paid the stockholders?

Mr. LANE. From 1912 to 1918 we paid out 8.6 percent of our earnings in dividends, and the taxes amounted to 8.3 percent for the same period, so that the Government got approximately as much as the stockholders did. But under this bill it would be approximately 35.7 percent paid out in taxes.

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

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

Senator BARKLEY. Back in 1913?

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

Mr. LANE. That is correct.

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

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

Senator BLACK. Do you have it by years?

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

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

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

Senator BLACK. Was it about even each year?

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

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

Mr. LANE. Yes, we kept all of that \$35,000 in the business, except \$3,006 paid out in dividends, and \$2,937 we paid in taxes.

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

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

The CHAIRMAN. How would it sap your business?

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

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

Mr. LANE. It fluctuates, of course. Last year, I think, according to the way the Internal Revenue Department figures it, we earned \$100,000 net.

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

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

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

Mr. LANE. Mr. Chairman, I will answer this way, last year we spent about \$80,000 in improvements in our plant, and this year we are planning to spend \$110,000 in improvements.

We could use our reserve to increase working capital, but we would have to become static in capital, and could not grow any more, as we see it. I cannot understand this tax bill and I have had lawyers, tax experts, and everybody else try to explain it, and I cannot understand it at all.

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

Mr. LANE. Yes, sir.

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

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

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

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

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

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

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

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

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

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

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

Senator BLACK. Double whose taxes?

Mr. LANE. Double our corporation tax.

Senator BLACK. Not the little company, but the company as it is now.

Mr. LANE. Yes, sir.

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

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

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

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

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

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

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

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

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

Senator CONNALLY. If you do that in the future, you will not pay any more tax than you do now, because you retain 30 percent in surplus and reserve, and you will then not pay as much as you do now.

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

Senator CONNALLY. All right, you may go ahead.

Mr. LANE. As I say, 29.9 percent reinvested. It took 23 percent more of our earnings to increase fixed capital to take care of the production that the increase brought about. So that there is approximately 53 or 54 percent that it took of our total earnings during that period for improving conditions of the plant and increasing net working capital.

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

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

Senator BARKLEY. If you keep \$80,000 and pay out \$80,000 under this bill, how much would the tax be?

Senator CONNALLY. Mr. Kent, can you figure that out? While Mr. Kent is doing that, Mr. Lane, just go ahead and state what the capital of your company is.

Mr. LANE. It is approximately a million dollars.

Senator CONNALLY. And you made \$100,000?

Mr. LANE. Yes, sir.

Senator CONNALLY. That is a very good profit, 10 percent.

Mr. LANE. Yes; but we have got to look back to 1932 and 1933.

Senator CONNALLY. We are out of the woods on that now.

Mr. LANE. No, I don't think so; but if so, while we are out of the woods now, we are looking for the next depression.

Senator BARKLEY. You are looking for the next depression?

Mr. LANE. Yes, sir. We paid out 31.8 percent for dividends, and I think that answers your question of a while ago. We have paid out 32

percent in round figures of our profits in dividends since we have been in business, but mind you, 84 percent of what we have paid out has been in the last 12 years of our life, or about one-half of our entire life of 24 years.

Senator BARKLEY. How many stockholders did you have when you first organized?

Mr. LANE. When we first started we had two, my father and myself.

Senator BARKLEY. As your business grew your neighbors and freinds bought stock?

Mr. LANE. Yes; we pleaded with them to help us out.

Senator BARKLEY. Your stock is not registered on the stock exchange?

Mr. LANE. No, sir; it used to be registered at Richmond, but when the Securities Exchange came on, we dropped it, so as not to be bothered with making the reports.

Senator BARKLEY. There is not much trading in your stock?

Mr. LANE. Very little.

The CHAIRMAN. Suppose you and your father had continued this business as partners when you first started, have you figured out how much tax you would have paid as individuals, as compared with what you would have to pay under this bill?

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

The CHAIRMAN. It would be a greater amount?

Mr. LANE. I presume it would be from what I have learned from copartnership arrangements. But my judgment is that could be corrected. It would seem to be it is important for a corporation to have a good start, because the point I am trying to stress is from my own experience, Mr. Chairman, how utterly necessary it is to keep every penny you can get hold of in your embryonic years as a corporation.

The CHAIRMAN. Yes; you have got to keep some money in the business, you have got to enlarge, but if it is a copartnership and they are paying taxes much higher than the corporation, and what we are trying to do is to put them on an even keel.

Mr. LANE. I think it is an unfairness that should be corrected in some way, but I am not sure the present one is the way to do it, since we calculate that in 1918 our company would have passed out of the picture if we had been compelled to pay taxes on the basis set up in this proposed bill.

Senator CONNALLY. Mr. Chairman, Mr. Kent has those figures now.

The CHAIRMAN. Will you state the result of what you have figured?

Mr. KENT. Since the corporation here was realizing a net income of \$10,000 or less, if it retained 50 percent of its adjusted net income it would pay a tax at the rate of 18.5 percent; 31.5 percent under those circumstances would be distributed in dividends to the shareholders.

The CHAIRMAN. Eighteen and five-tenths percent of what was distributed.

Mr. KENT. Eighteen and five-tenths percent of its net income.

The CHAIRMAN. Its net income was how much, did you say?

Mr. KENT. Say they had \$10,000 of net income, they retained \$5,000 in surplus, and they would pay taxes of \$1,850 and would pay out dividends of \$1,500, and when they get into the higher income groups between \$10,000 and \$40,000, under schedule 3, there is a

somewhat different rate, and after they get paid \$40,000 they would pay 35 percent.

Mr. LANE. We earned last year \$160,000, and retained half of that; how much would the tax be on the rest?

Mr. KENT. If my arithmetic is correct, it would be about \$50,000; but that does not take into account there are other means of keeping the money without paying the maximum tax.

Mr. LANE. That still leaves us where we cannot learn much about the law from the study we have been doing since the President suggested it and since we got the first report from the Ways and Means Committee.

Senator CONNALLY. This \$160,000 profit you made, was that after depletion, amortization and all of that figured off?

Mr. LANE. Yes; that is net profit.

Senator CONNALLY. For income-tax purposes?

Mr. LANE. Yes, sir.

Senator HASTINGS. Was it after the taxes were paid?

Mr. LANE. After all taxes, but no dividends.

Senator HASTINGS. You did not deduct the income tax from that?

Mr. LANE. No, sir. In this connection I might say our books do not agree with the Internal Revenue Department because they do not allow us to count off taxes the depreciation we have. Our experience teaches us we have an obsolescence factor in equipment from the standpoint of style changes, of which we have had four in 24 years, but they will not recognize those things we think they should recognize.

The CHAIRMAN. Is that due to the peculiar styles of furniture?

Mr. LANE. Yes, sir; that is correct.

Senator KING. You are not making any solid furniture?

Mr. LANE. Yes, we do; but we are specialty manufacturers, making primarily cedar chests.

The CHAIRMAN. You will admit you make as good furniture as any other manufacturers?

Mr. LANE. Yes; of course.

Senator BARKLEY. You do not make any antique furniture?

Mr. LANE. Not much, but we have a set of furniture, a duplicate of the Mount Vernon furniture, but that is high-priced furniture, and we do not make any money out of it. Our cedar chests, on account of being nationally advertised, we can get a volume of production on it and can make some money on it.

The CHAIRMAN. If you want to, one of the experts on this proposition of figures will be glad to cooperate with you and tell you everything about it.

Mr. LANE. I think we have learned a lot today, gentlemen, but I want to say this: We know that twice during our business career, 1918 and 1922, if these taxes had been in effect we would have been totally insolvent, because the taxes proposed under this bill appeared to us to be three and a half times what they would be under the old law that existed at that time.

Senator CONNALLY. If you had been a partnership instead of a corporation, you would have been "busted"?

Mr. LANE. I think so.

Senator CONNALLY. What about the individuals that are partnerships and paying the higher taxes? You have been getting off with

a lower rate than you would have if you had been an individual or partnership?

Mr. LANE. They have a perfect right to organize a corporation any time they get ready.

Senator CONNALLY. Yes; that is correct.

Mr. LANE. That is what I would do; I would never operate a personal business instead of a corporation.

Senator CONNALLY. You have paid less taxes because you were not a partnership.

Mr. LANE. Yes; there was no corporation tax when we organized.

Senator BARKLEY. There are other advantages of organizing as a corporation, because you are only liable to the amount of your stock.

Mr. LANE. Yes; and we were glad from 1912 to 1922 that we were a corporation. I heard the statement this morning—that if we wanted to keep our profits in our business we could offer stock rights and things of that kind to our stockholders. That might sound like a remedy, but in between 1912 and 1922, if our stockholders had ever gotten hold of any of our earnings as profit they would have taken them and run with them; they would never put them back into the business. If I could have gotten half of mine at that time I would have said to the creditors, "You can have the rest of it."

You must understand the small corporations have no access to the capital markets when they can only get money by selling stock to friends and borrowing from the banks and things of that kind, and under this bill I don't see how a small corporation ever can get anywhere.

The CHAIRMAN. But you are pretty much out of that class now.

Mr. LANE. We just claim we are green country boys trying to make a living.

Senator HASTINGS. Would you mind telling how many shares the largest stockholder holds in that corporation?

Mr. LANE. I own the largest number—35 percent of 10,000 shares.

Senator HASTINGS. Are you engaged in any other business?

Mr. LANE. No; this keeps me plenty busy; and during the last 3 years I have been kept busier than I want to be, because we have to look after our business and watch Washington all at the same time.

Senator BARKLEY. And you do not want Washington to exercise the same supervision over you?

Senator BLACK. You say in the last 3 years you have been watching Washington?

Mr. LANE. Yes, sir.

Senator BLACK. You did not have time to watch Washington in 1932?

Mr. LANE. I have had more time than in a long while recently, and I could play golf in those years, but not the last couple of years; I haven't had time.

We talked this matter over with a concern in Lynchburg, and took his figures and projected them since he started in 1916 with the figures under this proposed tax bill. We do not claim it would have put him out of business, but at times he would have had a heavy squeeze.

In 1912 we started working 12 men, and today we work about 500, and over 400 in the plant. We figure if this tax had been applied

we would have been working about 250 today—just about half as many.

If we had not had working capital in 1931, 1932, and the early part of 1933, we would have discharged half of the employees we had and cut the wages of the rest of them as much as we could and tried to make some money in those years, but we did have working capital and we kept all of our people on, except only those who dropped out of their own accord and we did not take back. We worked them short hours, sometimes 12 or 15 hours a week; we took our loss, but tried to keep those people busy. If we had not had working capital we could not have done that.

Frankly, when we projected this little expansion program last November and December which we are working out now, if I had dreamed then this new tax bill was contemplated, I would not have put on this expansion program. We just bought a machine yesterday, a big triple-drum sander from a concern in Wisconsin.

Senator CONNALLY. You bought it yesterday, when you knew about this bill?

Mr. LANE. We had the building all ready, and we had to put something in it. They told us that is the third machine they have sold in 6 months.

Senator BLACK. Did they tell you how many they sold in 1932?

Mr. LANE. I presume they did not sell any, and probably they took some back.

The CHAIRMAN. Business has improved in your line of business, however?

Mr. LANE. I think it has improved, but the capital-goods industry has not improved yet, with the exception of a few.

The CHAIRMAN. That is the general impression, that business is improving.

Mr. LANE. That is true. Frankly, I am not here throwing rocks at anybody; I have been a Democrat all of my life, but if you could get off our backs for a while, quit threatening us with all types of legislation, and let us see where we can go, we will be a lot better off. I will be so glad when you fellows adjourn, which I hope will be next month.

Senator BARKLEY. You would rather we would adjourn before we pass this tax bill?

Mr. LANE. I surely do. This new law to us seems a provision against plowing back the profits into the business. It will seriously injure the capital-goods industry, as a large percent of the business they get is the result of profits being used to expand business facilities. If this act is passed in anything like its present form, then credit should be allowed against profits used in increasing facilities, and we believe that ought to be done if it could be made workable.

Of course, you realize when you increase taxes you are transferring spending power from individuals and business to the Government, and the more you take the less individuals and private industry can have to expend, so that we cannot be responsible for reemploying people, because we haven't anything to employ them with.

I am just giving you as a layman the businessmen's point of view, and I appreciate your attitude, because you are not treating me very rough.

We believe a good deal of the suffering of the last depression was due to income taxes. By business in the last 20 years, because history teaches us we have fat and lean years, and if we do not lay aside for the lean years while business is good in the fat years, we will be put out of business in the lean years.

If it is politically impossible to enact a sound basis of taxation from an economic standpoint and you feel it is necessary to increase the Government's revenue through taxation, then why not continue the present basis and increase the rate to the amount absolutely necessary to be raised, then we can calculate, as we already know how much reserve we have to set aside to meet those taxes.

The CHAIRMAN. Have you any idea how much we would have to increase the flat corporation tax in order to raise the money we have to raise this year?

Mr. LANE. I have not figured that out, but if your tax is, roughly, 15 percent, if you raise it to 30 you ought to double it. I don't know how much you would lose in the shuffle, because the higher you raise it the more ways will be found to evade it.

If you increase it 5 percent, you will increase it a third; then if you want to tax the surplus, or make an experimental tax like Mr. Klein suggested, I think it would be a good idea.

It seems to me unsound to try to trade a certainty for an uncertainty. You know how much revenue the present taxes will raise, and you can estimate quickly how much a certain increase in the present tax will yield. The Treasury Department can estimate what the taxes will yield on the basis of 1934.

This tax closely approaches, if it does not actually reach, confiscation.

In other words, you are under this bill eating the seed corn.

I have always thought that all of us have just learned how to make out the old returns and the law has not been radically changed enough that we cannot still have lawyers and tax experts to make out our returns, but on this new bill I have had lawyers and experts figuring it, trying to find what our tax would be on last year's income, and no two agree about it. This is the most complicated thing ever suggested in the history of the world on taxation, and I defy any man in Congress, as he goes along in the year, to figure within 25 percent of how much he will have to set aside for a commitment on this tax.

The CHAIRMAN. You could do that in December.

Mr. LANE. Yes; but the year is over, and supposing you have spent something in improvements. At the present time we can tell how much taxes we have to set aside each month.

Senator BARKLEY. You do not have to estimate the amount of taxes until the tax year has passed, and you have 3 months in which to figure it all out before you make out the return, and it is the same proposition, depreciation, depletion, bad debts and all of that is involved in the present law, so that you have to go through the same tabulation to arrive at your net income under this bill, as you do now.

You may be able to get some additional credits under this bill that you do not get now, but after you have arrived at your net income for the year, then the only question is how much you are going to distribute, and when you have decided how much you are going to dis-

tribute, then you do not have to worry about the part you distribute, you only worry about the part you keep.

Then, there is no more obligation on what you keep than there is at the present time.

Mr. LANE. I do not see as a practical business man, myself, how we could tell us we go along during the year what your tax will be.

Senator BARKLEY. You cannot do it now.

Mr. LANE. Yes; we can estimate it closely now.

Senator BARKLEY. You do not know how much the income for the year will be until the year is over?

Mr. LANE. But we can take the profit each month and multiply it by the number of months, and come very close to it.

Senator BARKLEY. You have got to arrive at your taxable income after the year has passed and you have gotten all of the credit you think you are entitled to. In the first place, you file the income tax according to what you think, then they come along and check it up, and maybe you do not agree, but finally it is settled. The complications in making out an income-tax return, it seems to me, will not be greater than they are now; and one advantage, you only pay one tax, you haven't got to worry about all of the other taxes you pay now.

Mr. LANE. As I said, we have gotten to the point where we can estimate what our taxes are for the year by multiplying by the earnings to date, and under the new bill you cannot tell until the end of the year what it will be.

Senator GEORGE. Your position is you are doing business all of the year, every day, and you are not watching for the end of the year to get to make our year tax return?

Mr. LANE. Yes; and suppose we pay quarterly, like we do, and we pay dividends; then if we haven't got money enough to pay the tax, what can we do?

The CHAIRMAN. There is a provision here that you can have them carry it over if you pay out too much.

Mr. LANE. Yes, sir.

Senator BYRD. You say you earned \$160,000; suppose you invested that \$160,000 in new plant, how much tax would you have to pay then?

Mr. LANE. We would have to pay as much as if we had kept the cash, as I understand it. As we go along during the year, if we need money for fixed assets, in order to make a certain style of chest and to take care of any supply of chests, we cannot determine how much money we will have for that purpose without changing our current position.

Senator BYRD. One other point, one of the last points made here, that prior to the passage of this bill a corporation may have contracted to build a plant, and in your circumstances, you had contracted to build a plant, and invested the \$160,000 of your earnings for this year, then you would pay 42 percent taxes.

Mr. LANE. Yes; clearly that comes down to us this year, in that we earned \$160,000 last year, and we had enough money in our working capital position to pay out \$110,000 and still be reasonably comfortable during the spring season, when the business is not as much as it is in the fall, and pay for our improvements, expecting we could take all of this year's profit we needed except the 15-percent

income tax and pay for the improvements and replenish our working capital position.

That is why I say if I had known this law was going to be offered I would not have made these improvements.

Senator BARKLEY. Suppose I owned a factory that has made \$160,000 a year profit, as an individual, and I wanted to build a new plant, and I put that \$160,000 in a new plant, I would have to pay taxes, I take it, in the \$160,000 bracket, would I not?

Mr. LANE. Yes; and I tell you if this tax bill goes through, I wish you owned the plant.

Senator BARKLEY. And that bracket would be higher than you pay as a corporation?

Mr. LANE. That is true, as I understand it, but do you believe, if you are conducting a business of this size under the present conditions, you would conduct it as a copartnership?

Senator BARKLEY. No; I would not, but there are people who do.

The CHAIRMAN. Mr. Lane, you made those contracts you referred to prior to March 3 of this year?

Mr. LANE. We signed the contract January 15 of this year.

The CHAIRMAN. Then this bill helps you out on that proposition.

Mr. LANE. We did not go into it without money.

The CHAIRMAN. This is on the money you made last year.

Mr. LANE. But I cannot replenish my working capital position under that.

There is one other thought I would like to give you. We believe the principle upon which this new corporation tax law is based is absolutely unsound. In the first place, the Government takes upon itself the responsibility of conducting the business by reason of its earnings it must pay out in dividends or suffer the penalty, without at the same time assuming the responsibility for the damage such action might cause to the business in the future.

In other words, the Government assumes the prerogative of management without assuming the responsibility for results.

The CHAIRMAN. Thank you very much, Mr. Lane.

The CHAIRMAN. The next witness is Mr. Paul H. Wilson, of Worcester, Mass.

STATEMENT OF PAUL H. WILSON, REPRESENTING THE GRATON & KNIGHT CO., WORCESTER, MASS.

The CHAIRMAN. Mr. Wilson, can you get through in 15 minutes?

Mr. WILSON. Yes, sir.

The CHAIRMAN. You represent the Graton & Knight Co.?

Mr. WILSON. Yes, sir.

The CHAIRMAN. What business are they engaged in?

Mr. WILSON. The tanning of hides, fabricating hides and leather, leather belting, and leather products.

The CHAIRMAN. If you have a brief and want to put it in the record, that will be all right, and then you can point out the main points to us, if you want.

Mr. WILSON. I am secretary and comptroller of the company and have been with this company for 27 years. I have been secretary of the company since 1926.

I am appearing before this committee at my own request and on behalf of the Graton & Knight Co. The purpose of my coming here is to point out to this committee the ill effects the proposed tax law will have upon this corporation. Under the provisions of section 15, the Graton & Knight Co. will be required to pay a tax of 22½ percent on its income, which is an increase of 50 percent, which increase is an undue hardship under the present conditions.

This company was organized in 1851 and has been doing business continuously since that date. Its business, as I have said, is the tanning of hides, manufacture of leather belting and leather products.

Our present capitalization as of January 1, 1936, is as follows: Preferred stock, 20,645.6 shares, \$2,056,560; common stock, 83,229 shares, \$1,037,875; surplus, paid in and earned, \$711,112.40; making a total of \$3,805,547.40.

Our outstanding preferred stock, consisting of 20,549.2 shares is held by 1,505 individuals, averaging 13.7 shares per person.

Our outstanding common stock, consisting of 82,977.8 shares, is held by 1,732 individuals, with an average holding of 47.9 shares. The stock of the Graton & Knight Co. is widely distributed.

In addition to the preferred stock and common stock outstanding, the company, after it was reorganized in 1926 issued bonds \$1,750,000, of which \$1,148,500 are still outstanding. The indentures securing the bonds provides for an annual sinking fund of \$75,000.

The company at the present time employs approximately 1,200 people, does business in every State in the Union, and has a small factory in Shanghai, China, and branches in Canada, England, India, and dealer representations in other countries of the world.

The company had a very prosperous period through its entire existence up to and including the year 1919. To that time the company distributed large amounts in dividends yearly.

During the World War our company had large contracts with the United States Government for the manufacturing of war materials, such as seabards, gun slings, holsters, and many other articles. At the request of the United States Government, we expended large sums of money during the war years in the erection of buildings and the purchase of large quantities of leather and other supplies for production of war materials. Immediately after the close of the war we had a plant capacity far in excess of our needs, and a large inventory of leather and supplies purchased primarily for war purposes.

At the end of the year 1918 we had an inventory valued at \$11,001,661.98 and were indebted to banks and other parties for borrowed funds in the amount of \$6,148,500. During 1919 we did not suffer financial losses, but during 1920 and 1921 heavy losses were sustained due in part to reduced sales volume, but mainly to receding prices on raw materials, most of which were purchased during the war period. In these 2 years our losses were, 1920, \$2,785,000; 1921, \$4,865,000; a total of \$7,650,000.

Our deficit at the end of 1921 was \$3,567,000. Dividends were paid during 1920, but early in 1921 dividends, after one payment, were discontinued on the common stock, and only three quarterly dividends were paid on the preferred. No dividends have been paid on the common stock since 1921. A portion of the 1921 dividends were paid in scrip.

During the years 1922 to 1925, inclusive, the company earned about \$625,000, and these profits, together with the cash realized by a reduction in inventories, was used to liquidate the company's indebtedness.

In 1927 the company succeeded in putting a bond issue, the proceeds of which were used to pay off bank loans.

Senator KING (interposing). May I interrupt you at this point, Mr. Wilson? Had you redeemed the first issue of bonds, the \$700,000?

Mr. WILSON. This is the same issue that I am referring to. They were issued in 1927.

Senator KING. I see.

Mr. WILSON. The terms of the indenture were very strict and rigid. In that indenture we agreed at all times to maintain a certain amount of net tangible assets. These terms, we were told, were necessary in order to sell the bonds. At the present time we are in technical default on these bonds, because of this particular section, in the amount of \$370,000. We have been advised by our counsel that it would be illegal for us to pay any dividends on any stock as long as we are in default on our mortgage indenture.

Because of the terms of the mortgage indenture, the company cannot pay dividends, as its earnings are required to meet the sinking fund and other provisions of the mortgage, yet under section 15 the tax on its earnings is at the rate of 22½ percent. Under the present law the tax would be at the rate of 15 percent or less, and this increase of 50 percent on the present tax is a further burden on a corporation which is trying to keep going ahead. I believe also that this section 15 should be further clarified so that Graton & Knight Co. and other corporations in similar situations would be sure to obtain relief under the section.

Our bond indenture does not specifically state that we shall not pay dividends but does state that our assets shall be maintained at a certain fixed amount as long as any bonds remain outstanding and unpaid. This provision prevents the payment of dividends. A failure in the payment of sinking funds would constitute a default under the terms of the mortgage, and the rights of all stockholders would be in jeopardy.

Senator KING. Have you maintained your sinking fund since the bond issue?

Mr. WILSON. Yes, sir.

Our company is one whose earnings are seriously affected by market prices of raw materials, namely, hides. During the past 10 years we have seen some very violent fluctuations in the prices of hides. Our inventories have always been taken on the basis of cost or market, whichever is lower, and due to these wide fluctuations of high prices, our inventory losses in the past have been large. On the basis of our present inventory a difference of 1 cent per pound on hide prices is equivalent to approximately \$140,000 on our total inventory, which at present is approximately \$3,000,000.

Senator KING. You mean the personal property amounts to \$3,000,000?

Mr. WILSON. That is the inventory itself.

Senator KING. All of your assets?

Mr. WILSON. No, sir; all of the inventory, including hides and leather in the process of tanning. I might say, that is, on the first

of the year the price of steer hides was 14 $\frac{3}{4}$ cents; today it is 13 cents. That reduction has wiped out practically all of our earnings for the year 1935.

The CHAIRMAN. You cannot hedge?

Mr. WILSON. It is rather risky.

The CHAIRMAN. You do not practice it.

Mr. WILSON. We do not.

We have had the unfortunate experience of having hide prices drop very suddenly at the end of the year, which has resulted in large inventory losses for us, compelling us to show losses for the 1 year, and large profits for the succeeding year, simply because we have had to price our inventories on the basis of cost or market, whichever was lower. In the year 1932, because of this condition, we showed a loss of \$923,000, whereas in 1933 our profits amounted to \$401,000. A large part of the profit in 1933 was due to the increase in hide prices.

The CHAIRMAN. What was it last year; did it show a profit or loss?

Mr. WILSON. Last year we showed a profit of about \$211,000.

The CHAIRMAN. What was it in 1934?

Mr. WILSON. As I remember, we lost about \$200,000 in the year 1934.

Senator KING. And in 1935?

Mr. WILSON. We made about \$211,000, after setting up a reserve for taxes of about \$40,000.

The CHAIRMAN. It has been the character of your business to fluctuate from one year to another?

Mr. WILSON. Yes, sir.

Senator KING. Is it your position it is your problem to build up your reserve rather than pay dividends?

Mr. WILSON. Yes, sir.

Senator KING. So that any tax levied upon that reserve or surplus is especially injurious in your opinion?

Mr. WILSON. We believe so.

Senator KING. And if you had a deficit you would be in greater default with respect to the obligations on your bonds?

Mr. WILSON. Yes, sir.

Senator KING. You might even be forced into bankruptcy any minute?

Mr. WILSON. Yes. We felt we were faced with such a condition in 1932.

Senator CONNALLY. But in such a year you would not have any taxes on net income?

Mr. WILSON. But we could not build up our reserve.

Senator CONNALLY. But you would not have a reserve where you had a deficit?

Mr. WILSON. For the preceding year.

Senator CONNALLY. This only deals with current income.

Mr. WILSON. But if our reserves are exhausted, we feel we must build them up in order to take care of future contingencies.

The CHAIRMAN. Do you feel you should take care of all of them out of your net earnings?

Mr. WILSON. No, sir.

The CHAIRMAN. About what percentage do you set aside when you are making a profit?

Mr. WILSON. We have never carried out any consistent policy of setting up a specified amount, but I would say about 50 percent, depending upon the size of our earnings.

The CHAIRMAN. You would not pay much more tax under this bill on a 50-percent reserve than under the present law, would you?

Mr. WILSON. My interpretation is we would pay 35 percent, if we did not get any relief.

The CHAIRMAN. If the reserve is 30 percent, you would only pay 15 percent, would you not—never mind, I do not want to go into all of that.

Mr. WILSON. The existing income-tax laws, which do not allow us to carry over losses, applying them against the profits of succeeding years, creates a hardship on the company. Increases or decreases in our inventory values do not create actual profits or losses. Profits or losses on book inventory values are book profits or losses only. Actual profits or losses accrue to the company only when the inventory is full fabricated and sold.

Due to the nature of our business, our inventory turnover is small, and to a certain extent it is impossible to avoid suffering great losses when hide prices recede.

Due to the losses which this company has suffered since 1926, due to the depression and other causes, amounting to \$1,259,000, our working capital has been impaired. We believe the only possible way to get working capital to carry on will be through earnings.

During the 10 years referred to, 1926 to 1935, inclusive, with deficits or losses amounting to \$1,259,000, it is interesting to note that our city, State, and Federal taxes for the same period of years amounted to \$886,236.

Senator KING. You have to pay that amount of taxes in that time?

Mr. WILSON. In those 10 years, sir. The first part, from 1926 to 1929, our profits were \$990,000, and from 1930 to 1935, inclusive, our losses were \$2,249,000.

The management of this company adopted at the very beginning of the depression a policy of releasing no employee who has dependents, unless absolutely necessary. While the employees' hours were reduced, all of our employees through the entire depression had an income, though it was a reduced one. Our plan of curtailment during the depression was, first, the elimination of the preferred dividends; second, the reduction of executive salaries; third, the reduction of office salaries, and, fourth, the reduction of wages. Our executives' salaries were cut from 35 to 60 percent, our office employees and sales employees, 40 percent, and the factory wages, 20 percent. Our company subscribed whole-heartedly to the program of the N. R. A. and lived up to absolutely every agreement of our code. We have absolutely made no wage cuts of any nature whatsoever since the codes were discontinued. The wages of our factory employees have been restored 100 percent, the salary cuts of our office employees have been restored 50 to 75 percent, and the cuts in the executives' salaries have been restored approximately 50 percent. If it had not been for our attitude during the depression, our financial condition at the present time might have been better.

With our present situation I doubt very much if we could do this again if we had another emergency like the depression.

Due to the inventory losses, which we may have in the future, and to the terms of our bond indenture and to our shortage of working capital, the proposed tax on undistributed earnings of corporations will prove a serious hardship to us. A 22½ percent tax on undistributed income as compared with the present approximately 15 percent would increase the tax payable to the Government 50 percent, as stated. We believe that such a tax would be extremely unfair to us.

Furthermore, in the event of an expansion of business whereby the company will have increased inventories and accounts receivable, the company will require all its earnings in order to have sufficient working capital to operate.

Due to the condition which the Graton & Knight Co. is in, the net earnings will be needed for working capital. Such working capital will not be in the form of cash, but in new equipment, inventories, and accounts receivable. The corporation does not have any excess cash and has no investments in securities which can be turned into cash, and is not in a position to make a cash distribution to the stockholders. The money is needed in the business.

While I represent Graton & Knight Co. alone, yet I believe there are many other corporations in a similar position to the Graton & Knight Co.

We realize that the Government must have income, and one of the principal sources of revenue is the taxation of income of corporations. However, I believe that the Graton & Knight Co. and other companies similarly situated should not have any increase in the rate of tax under these circumstances. Unless we work out from under this default our tax rate would immediately step up to 42½ percent; if we do get relief under the law, our rate would be 22½ percent, and even at that I doubt very much if we would be in a position to resume dividends.

Senator WALSH. You are not paying preferred dividends?

Mr. WILSON. No, sir.

Senator WALSH. Since what time?

Mr. WILSON. 1931.

Senator WALSH. And you are not paying any dividends on common stock since when?

Mr. WILSON. 1921.

Senator WALSH. Are you meeting interest on your bonded obligations?

Mr. WILSON. Yes, sir.

Senator WALSH. About how much a year is that?

Mr. WILSON. About \$65,000 a year.

Senator WALSH. Did you say how many employees you had?

Mr. WILSON. About 1,200.

Senator BLACK. You said you had not reduced wages since N. R. A.?

Mr. WILSON. That is right.

Senator BLACK. Do your employees still work the same hours?

Mr. WILSON. No, sir. During 1933, in the middle of 1933, when the N. R. A. became effective, our business improved to the point where we could work our employees 40 hours. At the present time they are working about 36 hours.

Senator BLACK. I mean the number of hours per day; how much were the hours per day under N. R. A.?

Mr. WILSON. Eight hours a day and 5 days a week.

Senator BLACK. You still work them 8 hours a day?

Mr. WILSON. When we have the business.

Senator BLACK. You have not increased the number of hours?

Mr. WILSON. No, sir; unless we have an unusual situation—

Senator BLACK. You mean only in exceptional cases?

Mr. WILSON. Yes, sir.

Senator BLACK. Are your employees organized?

Mr. WILSON. Not that we know of.

The CHAIRMAN. You spoke of undue hardship due to the terms of your bond indenture. We will look into that phase. As expressing the views of one member of this committee, I think the provision as to contracts made before March 3 and consummated, we should change that, because if anybody has made a contract, has incurred an obligation, before March 3, whether consummated or not, if there were negotiations at that time, it ought to apply.

Senator KING. If the obligation is incurred the liability would result under the contract.

What was the beginning of the dull period in your company?

Mr. WILSON. We noticed a falling off in business in the summer of 1929.

Senator KING. You had 5 dull years?

Mr. WILSON. With the exception of 1933, when we did enjoy somewhat better business.

Senator KING. Prior to 1929 was your company indebted; did it owe any money?

Mr. WILSON. Yes, sir; previous to 1918, no.

Senator KING. 1929.

Mr. WILSON. Yes, sir; we were in debt. Our bond issue was dated March 1, 1927.

Senator KING. You ran a loss of \$3,000,000 during the 5-year period; is that correct?

Mr. WILSON. Yes, sir.

Senator KING. How did you take care of that? Did you issue more bonds, or do you still owe the money?

Mr. WILSON. No, sir. We have met our sinking-fund requirements every year. We have reduced our inventories, reduced our working capital, and used the money to meet these debts and also to take care of our deficits. We have spent little or nothing on new equipment.

Senator KING. Do you know of any way that a business concern can establish a credit other than through a reserve and paying its bills when due?

Mr. WILSON. Having a reserve—not unless we have good earnings every year and we are in a position where banks might be willing to loan us money.

Mr. Chairman, I would like to add a further thought. I believe that my limited contact with the Federal income-tax law since we have had that law indicates that while it may be imperfect in some respects, still we have had that law for a great many years, and it seems to have been more or less perfected, and it seems to me rather, perhaps, too bad to pass that law up and substitute one that we do not know what it will produce. I would like to recommend the

thought to the committee that we take the present tax law as it applies to corporations and individuals, leave the law as it is, and add a percentage to the tax paid by every corporation and individual in order to help the Government over the present crisis.

Senator KING. What do you think of my suggestion that—of increasing the corporate tax up to 18 percent on income over \$40,000 and then increasing the income tax upon the individuals, the normal tax, from 4 percent to 5 percent, and then a gradual increase in the surtax, particularly reaching those incomes of from \$20,000 to \$50,000, and then on up into the higher brackets, and raise about \$900,000,000 in that way, and maintain the present tax structure?

Mr. WILSON. I am not in a position to discuss the surtaxes or the higher brackets, but, as a businessman, I believe the businessman today would favor an increased tax rate. I believe that the individual paying the normal tax also should have his tax raised. I believe the tax should be passed along to everyone. Incidentally, I believe that if Congress would give the businessman encouragement of that sort and other encouragement, that the businessman would be willing and ready to go ahead and that business conditions would improve through an increase of the tax rate. I believe that the businessman should be assured that Congress pledge itself to operate or to conduct itself as economically as it possibly can in the wise expenditure of money, as I believe you will get the cooperation of the businessman. I believe the businessman today feels Congress is antagonistic to him, and I believe the majority of businessmen in this country are just as loyal citizens of the United States as any other class of citizens.

Senator WALSH. Will the experts inform us how much increase there will have to be in order to meet the amount of money required under the bill; what would be the increase in the rate of corporation tax?

Mr. KENT. If the increased amount were gotten under the corporate banks, it is estimated it would have to be about 25½ percent; that is, an increase of about 10½ percent in the present rate. There would be about \$60,000,000 additional revenue for each 1 percent increase in the corporate rate. I do not have the details with respect to the increases in the individual rate.

Senator WALSH. I do not think you understand my question. You want to raise \$800,000,000?

Mr. KENT. Yes.

Senator WALSH. And you want to raise it by levying a certain percentage of increase in the amount of tax being paid by corporations under the existing law; what would that percentage have to be on the average?

Mr. KENT. It would be between 25 and 30 percent, Senator. At the present time the estimates for 1936, under the present law, were about \$1,100,000,000 from corporate taxes and about an equal amount from taxes on individual incomes. Now, to increase that by \$600,000,000 would mean between 25 and 30 percent.

Senator WALSH. So you would have to announce to the taxpayers that their taxes would be increased 25 to 30 percent?

Mr. KENT. Yes.

Senator BLACK. Do you believe, Mr. Wilson, that profits derived by a person through his interest in a corporation's stock should be subject to any higher or lower rate of taxation than the profit derived from any other line of business?

Mr. WILSON. I am afraid I do not quite understand.

Senator BLACK. I will ask you in another way. An individual or partnership can make a profit on trading in various ways, or an individual can buy stock in a corporation and depend upon profit in the stock of the corporation. Do you believe it fair that the rate he pays on his profit on the corporation's stock should be the same as the rate he pays on the profit he receives from other lines of business endeavor?

Mr. WILSON. My offhand answer would be "yes."

Senator BLACK. If there is a system, whatever the system is, that makes some individual pay more on his profits derived from a corporation's stock than he does from other profits, and makes other individuals pay less on their profits derived from corporation's stock than is paid on profits derived from any other industry, that should be changed, should it not?

Mr. WILSON. I think so, without knowing all the conditions—

Mr. BLACK. The only condition I am speaking of is, a man may make a profit in several types of endeavor, trading as an individual, from a profession, from any line of business activity, including an investment in a corporation, or an investment in real estate as an individual. Now, as a matter of fairness, no system should be permitted to stand, should it, if it gives certain individuals an exceptional rate by reason of their investment in a corporation and a much higher rate on income from individual investment; that should not be allowed to continue?

Mr. WILSON. I do not think so.

Senator BLACK. It is wholly unjust and contrary to everything we believe equitable, is it not?

Mr. WILSON. I think so.

The CHAIRMAN. Thank you, Mr. Wilson. The next witness is Mr. R. C. Fulbright.

STATEMENT OF R. C. FULBRIGHT, REPRESENTING THE SOUTHERN PINE ASSOCIATION

The CHAIRMAN. You represent the Southern Pine Association, Mr. Fulbright?

Mr. FULBRIGHT. Yes, sir.

The CHAIRMAN. Can you finish in 20 minutes?

Mr. FULBRIGHT. I wish to go into some phases of the estimates here.

The CHAIRMAN. Try to get through as briefly as you can.

Mr. FULBRIGHT. Before going into the presentation for the Southern Pine Association I want to take a minute to mention one other matter, and that refers to the amendment made in section 115 (c) at page 108 of the committee print, part I, of the bill before you. That section deals with distributions by corporations in liquidation. It has been very widely changed by the House upon recommendation of the Treasury Department so as to provide that where there

a complete liquidation of a corporation the amounts received will have the benefit of the provisions of the capital, gains and losses, section 117-a. That has been the law previous to 1934, but in 1934 this section was changed so as to eliminate corporate liquidation from the capital gains and losses provision. Now, it was so left in 1934 that it constitutes a trap in some cases to unwary taxpayers to fall into it. In other words, if a corporation liquidated and distributed its properties to its stockholders, the stockholders did not get the benefit of section 117 with respect to capital gains, whereas if the corporation sold its stock to another corporation and that other corporation liquidated it to its stockholders, they got the benefit, and they could liquidate without any profit.

We have had some correspondence from people in the chairman's State and in Louisiana who got caught in that, and the only thing we ask is that the provision be made retroactive to December 31, 1934, where there are cases where companies were caught in that trap last year.

Senator KING. Some have paid their taxes after having been caught in the trap.

Mr. FULBRIGHT. It should be made retroactive to 1934, because it has been an unjust situation and is so recognized.

Senator KING. If some have already paid we will no doubt have legitimate and equitable demands from those who have paid.

Mr. FULBRIGHT. I think so.

I wish to state that the Southern Pine Association represents the softwood industry of the South; we have numerous small corporations, a few fair-sized corporations and we also have numerous partnerships in our industry. The Southern Pine Association has not had an opportunity to pass upon the provisions of this bill, but prior to its annual meeting on March 30 there was released from Washington the first report of the subcommittee of the Committee on Ways and Means—

Senator KING. What percent of the lumber business of the South, the pine business of the South, is embraced in your organization, 10, 20, 50, or 100?

Mr. FULBRIGHT. I should say about 50 percent. There are numerous small mills and we cannot very well keep track of all of them; they move from place to place.

In that proposal there was also a proposal to tax distributions from reserve—

The CHAIRMAN. Just confine yourself to this bill, Mr. Fulbright.

Mr. FULBRIGHT. The association considered the proposal which has been eliminated by the House. I shall not discuss it.

With regard to the general scheme of taxing undistributed net income, it was fully realized that while it would result in reducing taxes to them, they went on record as not approving the general principle involved in the bill.

Now, much of the comment that I make on this bill will not be matters which have been passed on by the association, but I have been engaged in the law practice and in handling tax matters for 25 years or more, and I have listened with great interest to the presentations that have been made, and I wish to say at the outset that I do not

believe there is any class of taxpayers today in this country that are demanding a tax reduction. Personally, I do not think this is the time for tax reductions. I believe we have necessarily had to undergo expenditures that make it necessary that we raise more revenue, and before I conclude I shall make some suggestions along that line, if I may.

But the more I have studied the estimates that have been presented to the Ways and Means Committee and to this committee, the more I am convinced they will not raise the revenue it is thought will be produced.

I wish to make some observations for the benefit of this committee along those lines.

Now, of course, corporate returns do not show to whom dividends are paid; likewise, individual income-tax returns do not show the corporation from which dividends are received. It is a very difficult matter from the data available to make any complete study of the subject, as the representatives of the Treasury have told you; but even if they could get complete data, from what corporations they came and to what individuals they were paid, it would still not throw much light on the question as to what individual taxpayers will receive the dividends which will be forced out of the corporations by the new legislation. It is not correct to assume that the same persons who return as income dividends from corporations under the present tax system will be the recipients of the additional dividends, for the reason that in a large percentage of the cases the additional dividends will go to individuals who do not hold any substantial amount of stock in corporations now paying dividends.

Senator KING. And under the present law will be exempt from the payment of taxes?

Mr. FULBRIGHT. Yes, sir.

We can compute what revenue will be lost, but we can only speculate as to what will be obtained. The Treasury experts estimate \$1,132,000,000. This is approximately 16 percent of the estimated corporate income for 1936 and is based upon the assumption that the entire corporate income will be distributed under the new law. Of course, this is not correct, because, as the Treasury points out, a substantial part of the income may be retained at a much less rate of tax than is now paid.

The CHAIRMAN. Do those figures include the 15-percent tax?

Mr. FULBRIGHT. They estimate a total of 16 percent; that is, the 15 percent plus the guesswork taxes called excess-profits taxes.

However, assuming that all of the corporate net income will be distributed, we must also assume that practically all of it will pay 4 percent, which will leave a net loss of \$844,000,000 to be compensated by surtaxes paid by individuals under the existing schedules.

In the case of corporations with small income it is admitted by the Commissioner of Internal Revenue that perhaps the majority of such corporations and a majority of the individual stockholders thereof will reap the benefit of a lower tax burden than they now sustain. According to the statistics for 1933, the latest year available to the public, approximately 15 percent of the corporate net income returned is received by corporations having less than \$50,000 net income. As

to these it may be said that there will generally be a substantial reduction in the combined revenue to be received from such corporations and their stockholders. In other words, none of the deficit will be made up from this class, but rather will the deficit of \$844,000,000 be increased by the opportunities which are available to closely held corporations to very greatly reduce the total tax burden of the companies and their owners.

By far the most important group of corporations from the standpoint of tax revenue is the class returning a net income of \$5,000,000 or more per year. In 1933 this class returned more than 30 percent of all corporate net income returned. This percentage, as well as that of the corporations having less than \$50,000 income, is rather closely in line with the percentages for these classes as shown by statistics for former years. If this enormous loss is to be made up, it is obvious that we should expect that a considerable part of it should come from the class of corporations having taxable net income of \$5,000,000 or more per year, particularly since they are by far the most important class.

An analysis of this class of corporations will disclose that the Government will not likely make up any part of the deficit from them and their stockholders. The reason for this is that most of the very large corporations have already built up reserves to conduct their business and follow the habitual policy of distributing nearly all of their net income from year to year. We have made an analysis of certain available data for the year 1933 and have used this because it is the latest year for which the revenue statistics are available. It will be noticed that in the presentation of the Commissioner before the House Ways and Means Committee actual figures were given only for 1933 and prior years. Round estimates were given for 1934 and subsequent years. In 1933, according to the report of the Bureau of Internal Revenue, there were 69 corporations returning a net income of \$5,000,000 or over and the aggregate taxable net income returned by this class was \$903,781,000, which constituted 30.29 percent of the taxable net income returned by all corporations. Our analysis shows that instead of obtaining additional revenue from this class of corporations under the proposed bill there will be in fact an added deficit.

Senator KING. If the 69 corporations whose net income exceeded \$5,000,000 constituted only 30 percent—

Mr. FULBRIGHT. Of the total income.

Senator KING. And the total is 1,000,000,000 plus—

Mr. FULBRIGHT. Yes.

Senator KING. It would seem to me there was an hiatus there somewhere.

Mr. FULBRIGHT. There are 69 corporations making returns of over \$5,000,000. Their total return was \$903,000,000. That constituted 30 percent of the total returned by all classes of corporations. We have examined the annual statements of corporations as published by Poor's Compilations of Corporate Data and took all corporations with incomes above \$5,000,000, and we selected 73 corporations. There were more than that number, but by combining them where

we knew they would be consolidated we found there were 73. These corporations represent, perhaps, an approximation of the group on which the Bureau of Internal Revenue based its figures.

Senator KING. That would be after their income tax was paid, their corporate tax.

Mr. FULBRIGHT. Naturally, the distribution of the corporation would be, Senator.

This does not include some \$20,000,000 of stock dividends.

Naturally, the income from these 73 corporations would be expected to be in excess of the taxable income figure reported by the Bureau of Internal Revenue. The range of net income, as shown in the annual statements for these corporations, was from approximately 5 to 137 million dollars, and in the aggregate total \$1,115,000,000. In the year 1933, against this income, these corporations distributed \$929,000,000 in dividends, or a percentage distribution of 83 1/2 percent of the total net income of the corporations.

Three corporations out of this list paid no dividends at all in 1933, although in the previous years of the depression they had continued to pay dividends even though their earnings, their earning statements, reflected deficits.

It is submitted that the figures for 1933 are not abnormal or out of line with any previous years from which such a comparison might be made for the reason that by 1933 many corporations had reduced their dividend rates from previous higher rates which had applied in 1930, 1931, and 1932.

Therefore, by taking the corporate distribution in dividend percentage of 83 1/2 percent and applying the schedules under the proposed Revenue Act of 1936, it can be seen that a taxable rate of slightly less than 5 percent would come into play. Five percent of \$1,115,000,000 would return to the Government only \$55,750,000 in taxes. Of course, under the new law it can be assumed that the distribution of \$929,000,000 would be subject to added taxation in the form of the 4-percent normal tax. Therefore, \$37,160,000 in additional revenue would arise from this source, or a grand total of \$92,907,000 of revenue which would come to the Government from the 1936 Revenue Act in its effect on corporations of net income over \$5,000,000.

The CHAIRMAN. Pardon me, Mr. Fulbright. I desire to announce that tomorrow morning we will start the hearing at 9:30; we have a great number of witnesses.

Mr. FULBRIGHT. Mr. Chairman, I apologize for taking your time, but I think this goes to the very heart of what we are doing here. The question is: Are we going to get the revenue hoped for under this bill?

Now, we have verified these figures in other ways. We took all corporations from the manual, showing \$10,000,000 or more of net income over the period of the last 5 years, and we went back for each of the years. In 1933 there were 58 of those corporations and they distributed 88.4 percent of their earnings.

In 1935 there was a less percentage; there were 51 corporations last year having earnings of more than \$10,000,000, with a total net earn-

ings of \$1,100,000,000, and they distributed \$905,000,000, or something over 78 percent.

Now, apply this bill to them and the average rate of tax would be 6½ percent. You would have a loss of approximately 5 or 6 percent on all of that class of the large corporations by the application of the bill. It would amount to many millions of dollars.

In 1934 the distributions of the similar class of corporations was 87½ percent. Back in 1931 and 1932 the corporations earning more than \$10,000,000 actually distributed more than they made. This was for the reason that those corporations had built up reserves out of which they could continue their dividend-paying policies.

I took a group of companies which I knew were outstanding companies, selected more or less at random. I took the total income and total dividends for 5 years. Those companies were the American Telephone & Telegraph Co., American Tobacco, Consolidated Edison, Corn Products, General Electric, General Motors, Pacific Gas, Public Service of New Jersey, Procter & Gamble, Reynolds Tobacco, Standard Brands, Union Pacific. They had a total income for the 5-year period of \$2,552,000,000 and total dividend distributions of \$2,637,000,000. There was not one of them that did not distribute more than 90 percent of its earnings for the period. I first had International Harvester included in that, but I took it out because I found, for the 5-year period, the International Harvester Co. had only earned \$15,500,000 and had paid out over \$54,000,000 in dividends. The International Harvester Co. kept its plant going and kept its men in employment out of what it had built up prior to that time; but I left it out of this calculation.

Senator KING. You found many companies that paid out in dividends more than their earnings?

Mr. FULBRIGHT. Numerous companies. You will find they all are companies with general stock ownership. On the other hand, we know there are companies that do not do that; they come into the small class. How are you going to make up this deficit?

It is my opinion that the estimate made by the Treasury that there will be 4½ billion dollars corporate net income for the year 1936 which would not be distributed under existing law but which would be distributed under the proposed law, is so highly speculative as to be of little or no value. This estimate is arrived at by estimating the total statutory corporate net income for 1936 will be \$7,200,000,000, or more than double the actual income of corporations in 1933, which was \$2,986,000,000. We may assume that this estimate is about as good a guess as we can make at this time. Personally, I am inclined to believe that it is about what is indicated under the latest available business statistics.

The CHAIRMAN. I did not understand the Treasury said that would be distributed, but that is the amount of undistributed income; they did not say it was distributed.

Mr. FULBRIGHT. I gathered that, and I may be in error; I cannot keep up with all of their figures, Senator. That is more than double the amount of income of corporations that had income in 1933. I am not criticizing that estimate, but from the analysis we have been able to make of the reports up to date, there will certainly be a much

larger income this year than last year, unless something we do not dream of now happens.

However, the assumption is made under existing law nearly \$2,700,000,000 will be paid in net cash dividends, whereas in 1933 the actual figures as to net cash dividends were \$2,102,000,000. The net cash dividends are arrived at by eliminating the dividends received by corporations. It will be observed that while it is estimated that the 1936 income will be considerably more than double that of 1933, on the other hand it is estimated that the net cash dividends paid will only be about 28 percent more. In other words, while the net income will jump from \$2,986,000,000 to \$7,200,000,000, the net cash dividends would only be increased from \$2,102,000,000 to \$2,700,000,000. The statistics of dividend payments by the large corporations, as available from various statistical bureaus, indicate a much larger proportion of income being paid out as dividends than revealed by the estimate of the Commissioner.

Now, taking the \$7,200,000,000, we estimate in this class of small corporations, the less-than-\$50,000 class, they have about 15 percent of the income, or \$1,080,000,000. There will be an 8-percent loss, a \$84,800,000 loss. Applying the 1933 base to those of \$5,000,000 or over, constituting 70 percent of the income, there will be a loss of \$129,000,000, or a total loss of \$214,000,000 to add to the \$844,000,000, making \$1,058,000,000 to be made up out of this intervening class. We do not think it can be done.

Senator BLACK. You mean all of the corporations under the new law, as you have computed it, the Government will draw a smaller amount of tax from them and their stockholders by the new bill than by the old law?

Mr. FULBRIGHT. I think that will be conceded, Senator.

Senator BLACK. And their stockholders and they would have to pay a much smaller amount of tax?

Mr. FULBRIGHT. Much smaller.

Comparative statement of income-tax burden under present and proposed revenue acts in case of corporations with small income

(By R. C. Fulbright)

For a convenient comparison showing the effect of the proposals in H. R. 12395 six illustrations are given, in each of which it is assumed that the corporation has an adjusted net income of \$20,000 and has three stockholders, i. e., Smith, owning 50 percent of the stock; Jones, owning 30 percent; and Brown, owning 20 percent. It is also assumed that the personal exemptions and deductions to which each stockholder should be entitled are exactly offset by salaries and other income.

In the first three illustrations (A, B, and C companies) the stockholders have no other taxable income than the dividends received from the corporations; whereas in the other three illustrations (X, Y, and Z companies) the stockholders have outside taxable income.

The A and X companies are situated so that they can afford to distribute all of their earnings. The B and Y companies cannot afford to distribute more than half of their earnings, while the C and Z companies can afford to distribute 70 percent of their earnings. The statements show the change in the tax burden under the proposed law and the discrimination which will arise against the less fortunate corporations.

	Stockholders	Dividends received	Under present law			Under proposed law		
			Individual taxes	Share of corporate taxes	Total taxes	Individual taxes	Share of corporate taxes	Total taxes
A company (distributes 10 percent of income)	Smith	\$10,000	\$500	\$1,320	\$1,820	\$700	None	\$700.00
Do	Jones	5,000	50	792	842	320	None	320.00
Do	Brown	4,000	None	528	528	160	None	160.00
Total		20,000	550	2,640	3,460	1,180	None	1,180.00
B company (distributes 50 percent of income (schedule II-A))	Smith	5,000	40	1,320	1,360	340	\$1,750.00	1,990.00
Do	Jones	2,000	None	792	792	120	1,050.00	1,150.00
Do	Brown	2,000	None	528	528	90	700.00	750.00
Total		10,000	40	2,640	2,680	440	3,500.00	3,890.00
C company (distributes 70 percent of income (schedule III))	Smith	7,000	130	1,320	1,450	410	\$43.75	1,273.75
Do	Jones	4,200	8	792	800	170	506.25	682.25
Do	Brown	2,800	None	528	528	112	337.50	440.00
Total		14,000	138	2,640	2,778	698	1,087.50	2,355.00

	Stockholders	Outside taxable income	Dividends received	Under present law			Under proposed law		
				Individual taxes	Share of corporate taxes	Total taxes	Individual taxes	Share of corporate taxes	Total taxes
X company (distributes 100 percent of income)	Smith	\$10,000	\$10,000	\$1,000	\$1,320	\$2,320	\$2,000	None	\$2,000.00
Do	Jones	5,000	5,000	500	792	1,292	620	None	620.00
Do	Brown	4,000	4,000	540	528	868	500	None	500.00
Total		20,000	20,000	2,060	2,640	3,320	3,480	None	3,480.00
Y company (distributes 50 percent of income (schedule II-A))	Smith	10,000	5,000	1,000	1,320	2,410	1,250	\$1,750.00	3,040.00
Do	Jones	6,000	3,000	460	792	1,272	600	1,050.00	1,650.00
Do	Brown	4,000	2,000	240	528	798	320	700.00	1,020.00
Total		20,000	10,000	1,700	2,640	4,450	2,210	3,500.00	5,710.00
Z company (distributes 70 percent of income (schedule III))	Smith	10,000	7,000	1,260	1,320	2,610	1,870	\$43.75	2,413.75
Do	Jones	5,000	4,200	134	792	1,346	722	506.25	1,228.25
Do	Brown	4,000	2,800	260	528	808	392	337.50	720.00
Total		20,000	14,000	2,124	2,640	4,764	2,984	1,087.50	4,371.50

I want to illustrate that by a table and data that has been passed up to the members of the committee. The first page is explanatory. We have taken A, B, C companies and X, Y, Z companies, and have assumed each has an income of \$20,000, an adjusted net income, we will say, of \$20,000. I wish to call your attention to the different assumptions. The first is that 100 percent of the income will be distributed; the second assumption is that 50 percent will be distributed; and the third is that 70 percent will be distributed.

Now, under the present law the A company, distributed 100 percent of its dividends, and we assume here that the three stockholders there, as the explanation shows, would have enough exemptions and

deductions to take care of their outside income, their salaries, and so forth. Under the present law that corporation would be taxed \$2,640; only two of the individuals would pay any tax because they would not get into the surtax brackets—that is, the third individual would not pay any tax. Under the proposed law the corporation would pay no tax and the individuals would pay only \$1,180.

You can see what the reduction is.

Now, then, the B company, we will say, has to improve its plant. Some of the lumber companies have said they need money to fix up the plant in order to manufacture a better quality of lumber than they are now able to produce, or it may be indebted in such a way it cannot follow the amortization plan that I would like to refer to if I had time. They have to retain 50 percent. You will notice that corporation and its stockholders are going to pay \$3,940, or more than three times as much as the fortunate corporation that did not have to hold its money to build up its plant or do anything like that.

The third example illustrates that where a 30 percent reserve is made and 70 percent of the income is distributed, there is actually some saving, as has been attested by the representatives of the Treasury Department. But in that case I wish to call your attention to the fact that those corporations will be taxed very much more than the partnerships in business doing the same amount of business and having the same net income.

There has been a lot of talk here about partnerships, and I want to tell you about the partnerships. Business of a business of any size is not conducted by partnerships. We have the statistics on that. The Commissioner sent telegrams to all of the collectors in order that he might have here for this hearing the number of partnership returns made last year. There were 205,432 of them; there were only 80 that had incomes of \$500,000 or more. They used an illustration of a partnership of \$500,000 income. Those partnerships were most likely professional partnerships; some of them may have been lawyers; it has been a great time for the lawyers, you know. Now, that is not all. Only 833 of the 205,000 had incomes of \$100,000 or more, four-tenths of 1 percent of them. But when you take the little businesses, I tell you that this bill makes it a lot harder on the corporation than the partnership, and this exhibit proves it.

Senator BLACK. I thought you said it reduces the little business' taxes.

Mr. FULBRIGHT. It does, provided they can distribute the money. Look at page 2. In the case of the company that has to hold half of it, it shows an increase in taxes of 50 percent, and will tax it three times as much as if it were a partnership and three times as much as the more fortunate corporation which does not have to hold its money.

Now, on the third page, we have assumed that each of the stockholders had outside taxable income of \$10,000, \$6,000, and \$4,000, respectively. Those are pretty good sizable amounts in my country, although they may be pretty small up here. They represent our best people, our business people down there. Where they distribute 100 percent of the income, the total taxes under the present law would be \$5,320, and under the proposed law they would be reduced to \$3,480. That may be nice, but those people are not demanding that taxes be

reduced now. All of this great mass of business concerns over the country, the meat and bread line, have any of them been sending you letters saying they want tax reduction at this time? Now, this Y company, we find the combined tax will be \$5,710, or 64 percent more than the tax of the one more fortunately situated.

Senator BARKLEY. You say they have independent income?

Mr. FULBRIGHT. It is shown in the column under outside taxable income, the \$10,000, \$6,000, and \$4,000.

It also assumes that the ordinary exemption for the family and the ordinary deductions will be offset by the salary the man receives.

Now, the Treasury says it is so easy to get around that by having them declare a dividend and then bring the money back in as added capital and points to the great privilege they have and the ease and informality with which small corporations may do this. I wonder how much experience those representatives ever had in the actual representation of corporations under the laws of some of our States. In my State of Texas, for example, before you can get authority to increase your capital stock it has to be subscribed, 50 percent paid in with money, or the equivalent of money, and checked by the secretary of state before he will grant authority to do it. If you are going to issue stock rights, you would get into something that is not recognized under our law, and preferred stock is not recognized. You have to make a contract with all of the stockholders and they will have to hire a lawyer. You are going to impose a lot of burdens on the small corporations. First, to hire a lawyer, who will have to see how he is going to work out his capital structure every time a dividend is declared, and then hire income-tax experts to see what bracket he is going to get in.

As I stated at the outset, there are a lot of our members who are going to get reduced taxes. I sent out a questionnaire and have gotten a few returns from it. I have noted a couple from the State of the chairman. One of them estimated that next year they are going to make \$60,000.

The CHAIRMAN. Was that a corporation?

Mr. FULBRIGHT. Yes. They said they had a close corporation, and they could pay that out and then pay it back. But there are a lot of them that cannot do that. Another one in an adjoining county gave an estimate of their debt; they wanted to take up the plant and only have a small income. They do not want it. That one was infelicitous; the other one did not need any money. They were going along fine.

The CHAIRMAN. How is it going to be a burden if they are given special treatment?

Mr. FULBRIGHT. They are only given special treatment if they get all of the stockholders to agree they will distribute it and pay it back. That will work all right in lots of cases, but suppose a stockholder dies and a guardian is appointed to represent minor children; the court is not going to let him invest that money in a corporation under the laws of my State or yours either. There are many cases where it cannot be done. It is fine in theory, but it will work out by causing trouble in practice. There are many cases where they can have a tremendous reduction in taxes; but, on the other hand, I do not believe they are expecting a reduction in taxes.

Now, there is another provision that was in the recommendation from the Treasury but which was changed on the floor of the House. They gave the corporation a 2½-month period after the close of the year to determine how much of the income it would distribute. In the House they crossed that out.

The CHAIRMAN. Do you not think that was a proper action?

Mr. FULBRIGHT. If they are going to get the money next year; but the trouble is that there are many companies that have not the remotest idea what their net income is until they take inventory at the end of the year, and then they are able to tell what they are going to do.

Senator KING. According to the decline in their inventory for the solvency of their debtors.

Mr. FULBRIGHT. The gentleman who talked about hides showed that where the price varied 2 or 3 cents he would be in a bad fix.

Senator CONNALLY. In order to offset a decline in the value of inventories that occurs after the first of the year in determining his ability to pay taxes, the decline should be coincidental with the income?

Mr. FULBRIGHT. They would take the inventory at the beginning of the year and at the end of the year, and until the latter one is taken they have no way to tell what it is.

Senator BARKLEY. Do you not believe that any concern that is run pretty well knows what it has made in December of a year?

Mr. FULBRIGHT. In manufacturing lines, yes, sir; but in cotton, with which I am familiar, a cotton merchant does not know where he is until he gets his inventory.

Senator BARKLEY. We will take the year 1936. Now, he will take that inventory after the 1st of January. He has up to the middle of March to make out his income-tax report. Will he not have all of that inventory information before he is required to make out his income-tax report so as to offset his earnings?

Mr. FULBRIGHT. That is perfectly correct, but under the law now they would have to determine what their distribution would be before the close of the taxable year.

Senator BARKLEY. Not necessarily.

Mr. FULBRIGHT. They would if they are going to get the benefit of the schedule in the bill. They cannot get the benefit of it otherwise.

I want to say this in conclusion—pardon me, Senator, did you have another question?

Senator BARKLEY. No.

Mr. FULBRIGHT. I want to make this suggestion, gentlemen: We had a tax bill passed in 1918 that produced more revenue than any special tax bill that was ever passed. We built up a body of regulations under it and a body of court decisions, and it was fair; that was the excess-profits tax. If a corporation made excess profits upon its capital, it paid a substantial additional tax. I do not think you will find a lot of business people hollering for it, but it will produce revenue. If we are going to have this doubling up of income, \$7,200,000,000 from these corporations, which the Treasury estimates, and I have no reason to believe the Treasury is not correct, I believe that we could by reenacting a tax on which we have the regulations, court decisions, and administrative methods all worked out, we could

get a very large amount of tax next year. I suggest that is an important thing for the actuaries to get busy on, rather than to launch into such a speculative thing. The Treasury says, "We are going to lose \$1,132,000,000"; now, where are we going to make it up? They point out the different ways in which they can keep from paying income taxes, and believe me, they will be doing it. The lawyers and tax experts will show them how they can do it, and to the extent they can do it you are going to lack making up the \$1,132,000,000, and unless you can get a more accurate statement than those which have been referred to, I do not think it is a good idea to embark on certain experiments.

Senator BLACK. Under this proposed legislation we are not likely to raise as much taxes as under existing law; is that your contention?

Mr. FULBRIGHT. I think we will raise as much, but I do not think we will get any substantial increase.

Senator BLACK. How much do you think it would be?

Mr. FULBRIGHT. I have not been able to complete my estimates, but those who pay 15 percent of the income, there will be a very large loss, and those who pay 30 percent, there will also be a large loss, and in the intervening class there will be a gain. How much it will be I have not been able to determine, as I have not completed my computations.

Senator BLACK. Have you examined what has been submitted by the experts?

Mr. BARKLEY. I have seen everything they have offered, both in the House and here. I can say I do not see where they are going to get any \$600,000,000 in addition to the loss of the \$1,132,000,000. They are going to lose \$200,000,000 out of the A. T. & T.; they will go scot free; they will not pay any tax, and the General Motors will not pay any tax.

Senator BLACK. How about the people who draw the dividends?

Mr. FULBRIGHT. Some members of my family have A. T. & T. stock, that is, my wife's kinfolks. Some of them have a very small income. It is not going to make a dime's difference to the Government as far as they are concerned.

Senator BLACK. How about those in the higher brackets; will it not raise them into a still higher bracket?

Mr. FULBRIGHT. The A. T. & T. will pay just what they have been—

Senator BLACK. I am talking about the stockholders of the A. T. & T. who draw dividends and who may be in one income-tax bracket, and if they draw more, it puts them in another.

Mr. FULBRIGHT. May I illustrate—

Senator BLACK. Does it, or not?

Mr. FULBRIGHT. No, sir.

Senator BLACK. It does not affect them at all?

Mr. FULBRIGHT. Not unless they have income from another corporation.

Senator BLACK. Suppose they have income from various corporations.

Mr. FULBRIGHT. May I answer the question in my own way, Senator?

Senator BLACK. Yes.

Mr. FULBRIGHT. Here is a man who has \$100,000 income to start with. He gets \$20,000 dividends from the A. T. & T. By virtue of this law being passed, you force some other corporation to pay dividends it did not pay before, and he gets more from them. That is where the added revenue comes; it is not because of the A. T. & T. All he pays is 4 percent normal on that, and the A. T. & T. gets out of 16 percent, a net saving of 12 percent. But by forcing another corporation to make distribution you get some money out of that, and that is where we can make it up, but I do not see how we will make it up.

Senator BLACK. Are you an accountant?

Mr. FULBRIGHT. No, sir.

Senator BLACK. Who assisted you in this?

Mr. FULBRIGHT. People in my office.

Senator BLACK. I am asking because your evidence is interesting.

Mr. FULBRIGHT. It has been worked up in my office; the junior member of the firm is responsible for the most of the figures.

Senator BLACK. Are you a lawyer?

Mr. FULBRIGHT. We are, and some of us have had to learn something about accounting and statistics.

Senator CONNALLY. I know Mr. Fulbright is a very able and capable lawyer.

Senator BARKLEY. There is a difference of 64 percent in two corporations with the same income.

Mr. FULBRIGHT. It would be a great deal more than that; that is, the combined tax the corporation and the stockholders. If one corporation was in a position to distribute all of its income and its stockholders did not have any other source of income, and the other corporation could only distribute half of it, in that case the one which could not distribute but half of it would pay more than three times what the other paid.

Senator BARKLEY. That would be a very great disadvantage.

Mr. FULBRIGHT. It is a great discrimination. This law will discriminate against small corporations in favor of small partnerships, because a partnership does not have to worry about whether or not they will withhold part of it or improve its plant; but if the corporation withholds some to improve the plant, it is going to pay three times as much as the partnership in the illustration I give.

The point I am trying to make is in case of small taxpayers it creates a tremendous inequality, and we have explained this to the lumber men and it does not appeal to them as being a good policy. I might say in my section we have many small oil-development companies that have to keep their money in the company in order to keep going in competition with the great Standard companies, the Texas Co., and companies like that, and I can see it would be a tremendous discrimination against companies of that sort.

Senator BLACK. Assume a corporation owes no money and has a big surplus, and here is another corporation that owes money and has no surplus.

Mr. FULBRIGHT. One, instead of paying 16 percent of its income to the Government, will not pay anything; the other, instead of paying 16 percent of its income, may have to pay anywhere from 17 up to 42½ percent.

Senator BLACK. Is it your view this bill works to the disadvantage of all of the corporations in this country which do not have big surpluses?

Mr. FULBRIGHT. I think ultimately that would be the effect, Senator. It does not necessarily do it to start with, because you have to take into consideration the position of the stockholders and whether it is closely held and whether they would take advantage of the loopholes.

Senator BLACK. One has a surplus and the other has to pay earnings.

Mr. FULBRIGHT. But if one has only three stockholders and they can declare the dividends and put them back into the corporation as paid-in surplus, they would be on an equality, but if they have one stockholder who keeps it, or a guardian is appointed, as I have pointed out, they would have to have lawyers and it would not be as simple as you are led to believe.

Senator KING. Have you some tables on the copartnership showing the number and how it affects them?

Mr. FULBRIGHT. I do not have anything on that, except there were some figures put into the record before the House Ways and Means Committee, at page 428.

Senator KING. Would you call two or three farmers who work together a copartnership?

Mr. FULBRIGHT. Yes, sir.

Senator KING. Has the Department so classified them?

Mr. FULBRIGHT. It follows the common-law concept. If it is a joint-stock association it may be a partnership under State law, but subject to taxation as a corporation. Many of our lumber companies are copartnerships.

Senator KING. I wondered whether they classified in the copartnership column a couple of sheepmen who work together.

Mr. FULBRIGHT. If they engaged in that business from year to year they are a copartnership; if they expect to dispose of the sheep the next year, it would be a joint venture.

Senator KING. A couple of men who buy a grocery store and have \$2,000 of stock, what is that?

Mr. FULBRIGHT. A copartnership.

Senator KING. Have you any figures showing the aggregate earnings of copartnerships measured by the gross earnings of all corporations?

Mr. FULBRIGHT. We do not have the comparative figures. The figures I referred to are for 1935, and we did not have available the other statistics. Those copartnerships include engineering firms, law firms, and service firms.

Senator KING. Not industrialists or manufacturers?

Mr. FULBRIGHT. No, sir.

Mr. CHESTNUT. We can give you the estimated corporate income for 1935, and since the tax yield is running so close to the estimate, it would indicate the estimate on income is exact enough for your purposes, and it would give you a basis for comparison.

Senator KING. I had in mind the gross earnings of partnerships and of all corporations.

Mr. FULBRIGHT. I doubt if there are a score of partnerships engaged in business in this country where they will run over \$100,000

a year. There are many law firms, and things of that character where they will run in excess of that. I was rather astonished to note that only four-tenths of 1 percent of 200,000 partnerships ran into that.

The CHAIRMAN. Was that reference you gave as to the earnings in the hearings on this bill in the House?

Mr. FULBRIGHT. On this bill; it was in the report.

Senator BLACK. Suppose a stockholder in a corporation makes sufficient income so that he is in the 65 percent brackets for the year and the company declares a dividend, adding \$10,000 to his income; what percentage of that \$10,000 would go to the Government for taxes?

Mr. FULBRIGHT. It would be in excess of 65 percent.

Senator BLACK. In excess of 65 percent?

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. If he was in the 45-percent brackets, it would be in excess of 45?

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. And if he was a stockholder down in the 4-percent brackets, it would be somewhere in excess of 4 percent?

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. Now, if he is paying under the present corporation tax and that profit stays in the corporation, the corporation would pay 15 or 16 percent on profit, would it not?

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. Whether he would have to pay 4 percent or 65 percent or 72 percent; that is correct, is it not?

Mr. FULBRIGHT. That is correct.

Senator BLACK. So that in the actual operation of the payment of tax on that profit it fluctuates from nothing up to 72 percent, so far as those dividends are concerned, as paid out to the taxpayer, dividends from the corporate profits?

Mr. FULBRIGHT. Oh, yes.

Senator BLACK. Now, the individual earnings, the partnership earnings, do not fluctuate in that way?

Mr. FULBRIGHT. No, sir. Whether they distribute it or not, they must return their proportion of the income of the enterprise.

Senator BLACK. So that in reality one of the issues here is whether or not the disadvantages you have described, so far as the corporation is concerned, outweigh an effort to prevent such a wide fluctuation in the amount of taxes paid on the profits which go from the corporation, as compared with the profits that the individual gets from other concerns?

Mr. FULBRIGHT. I do not deny there are inequalities, but that is very rare, because business is generally run by corporations, and only small enterprises are run as partnerships.

Senator BLACK. Take yourself, as a lawyer.

Mr. FULBRIGHT. I would get stuck with it.

Senator BLACK. You have to pay on the amount of the brackets in which you happen to have your earnings?

Mr. FULBRIGHT. That is correct.

Senator BLACK. But if someone else invests in a corporation, even though he may have a large income of several million dollars, which would place him in the higher brackets, on the profit made on the

corporate stock he would be below the rate you would pay on your income, even though you are in the low bracket?

Mr. FULBRIGHT. But when he dies the Government will get theirs.

Senator BLACK. The Government may and it may not. If that stays there for 5 or 6 years and they declare a dividend, or suppose he sells it.

Mr. FULBRIGHT. Then he pays profit on the increase in value.

Senator BLACK. A tax on the profit?

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. What percentage of profit?

Mr. FULBRIGHT. If it comes in the capital net losses or gains, it would be in the schedule which runs from 1 year to 10 years, and scales from 30 to 90 percent.

Senator BLACK. And he formerly paid 12½ percent?

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. We changed that by the most recent law.

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. You have read where one man who everybody knew was very wealthy has paid no income tax at all, even though the corporations through which he did business, many of them, made profits, Mr. Morgan; if dividends had been declared on the stocks he had in various corporations, he would have had to pay an income tax, would he not?

Mr. FULBRIGHT. Yes, sir.

Senator BLACK. And the probability is if the dividends had been declared these corporations would have had to pay far above what the normal man would have to pay?

Mr. FULBRIGHT. Yes.

Senator BLACK. And to that extent it is an unfair operation of the present law?

Mr. FULBRIGHT. I know there are inequalities and I do not know any formula that will get us away from all of them, but if you had the excess profits tax, Mr. Morgan would pay a lot more.

Senator BLACK. You know that every effort we make to enact any kind of tax law that reaches those gentlemen is difficult; there are numerous holes and they always find them.

Mr. FULBRIGHT. I said before this committee when the 1934 act was up for discussion that a proper administration of a law like section 351—

Senator BLACK. What is that?

Mr. FULBRIGHT. That is where they allow the gains to accumulate in a corporation beyond the needs of the business enterprise.

Senator BLACK. That is 102, is it not?

Mr. FULBRIGHT. One hundred and two is the personal holding company, but 351 permits gains to accumulate where there is a presumption they are needed for investment in the company such as that.

Senator BLACK. It certainly is our duty to make an effort—we know we cannot have a perfect tax law, but we should see that no particular group is permitted to take advantage of any kind of device to pay smaller amounts of tax on their profits than others.

Mr. FULBRIGHT. But here you do just the opposite.

Senator BLACK. I understand that is your construction.

Mr. FULBRIGHT. There is no question about the correctness of that construction.

You asked a question about the increase in the number of copartnerships. When the Commissioner was on the stand he stated that in 1926 there were 295,000 partnerships and in 1935, 205,000; but if he had gone back to 1925 he would have shown there were only 209,414 partnerships making returns in 1925, or approximately the same as 1935. In 1918 there were only 160,000; in 1917, 75,000.

Senator BLACK. How many corporations in 1918?

Mr. FULBRIGHT. About half as many as now.

Senator BLACK. As a matter of fact it is true the corporation has been used as a device to keep from paying as much tax as they would have to pay doing business as a partnership or individual?

Mr. FULBRIGHT. That is the reason we enacted the sections I referred to—I may have to correct myself. I thought section 351—

Senator BLACK. That is immaterial.

Senator KING. Is it not a fact that individuals who have no purpose to evade tax find that because of the change in partners and other difficulties, it is advantageous to form corporations, because in this country you can conduct your business more effectively and economically and with less uncertainty through a corporation?

Mr. FULBRIGHT. Senator, if that were not so, there would not be any corporations, because they are the most vulnerable creatures to taxation by States, requiring reports, inspections, and things of that character. It is necessary where you have a large number of individuals interested in an enterprise to incorporate. When you have six or eight partners, as in my firm, we have some pretty big arguments, but when you get that in a business enterprise it breaks down of its own weight.

Senator BLACK. You can think of no reason why profits made through an investment in a corporation should not be taxed just as greatly as profits made by investment in real estate or professional business, or anything else?

Mr. FULBRIGHT. Oh, yes; there is.

Senator BLACK. What is it?

Mr. FULBRIGHT. It depends on the character of the business the corporation is engaged in. If they are engaged in the same character of enterprise, then you are correct.

Senator BLACK. There is no argument you can think of so far as the corporate device is concerned—there is no reason you can think of why profits received from a corporation as such should not bear just as much of the burden of taxation as those received from any other business?

Mr. FULBRIGHT. For example, this matter of surplus which was discussed this morning; there is a lot of difference between additional capital subscribed and piling up surplus. You cannot declare dividends and impair capital, but you can cut down the surplus.

Senator BLACK. Is there any reason, so far as our economic system or governmental system is concerned, why profit made in investment in a corporation should be subjected to either a smaller or greater amount of tax burden than profits made by an individual or partnership?

Mr. FULBRIGHT. I would have to take into consideration all of the factors.

Senator BLACK. I am talking only about the corporation as such. Is there anything sacred about a corporation?

Mr. FULBRIGHT. No.

Senator BLACK. Is there any reason why a person making a profit out of a corporation, as such, should be subjected to a greater or smaller tax than on profits made in some other way than by a corporation?

Mr. FULBRIGHT. I cannot answer that solely from the standpoint of Federal taxation.

Senator BLACK. Any standpoint.

Mr. FULBRIGHT. If they are in the same enterprise the burdens should be the same so far as Federal tax is concerned, but in the State of Texas a partnership does not have to pay anything. You have to take all of those disabilities into consideration.

Senator BLACK. I mean a corporation, as such, and because of the fact it is a corporation.

Senator KING. The following witnesses will be here at 9:30 tomorrow morning:

R. N. Denham, S. A. Sweet, Arthur T. Davenport, James I. Donnelly, Smith F. Ferguson, T. J. Priestley, Jr., Fred R. Fairchild, J. W. Oliver, and John W. O'Leary.

The committee will stand adjourned until 9:30 tomorrow.

(Whereupon, at 5:05 p. m., the committee adjourned until Saturday, May 2, 1936, at 9:30 a. m.)

x

NEW YORK TIMES May 1, 1939

SENATORS MOVE TO INCREASE TAX BILL YIELD \$190,000,000 AFTER PLEA BY MORGENTHAU

SECRETARY URGES ACTION

Deficit for June 30 Put
at the All Time High
of \$5,966,000,000.

INCLUDES ALL OF BONUS

Maximum Outlay Calculated
for the Fiscal Year, Despite
Nine-Year Amortization.

PROFITS TAX PLAN BACKED

Finance Committee Moves to
Simplify House Rates and
Corporation Classes.

By **TURNER CATLEDGE**

Special to THE NEW YORK TIMES

WASHINGTON, April 30.—A movement to simplify the \$603,000,000 Tax Bill, passed yesterday by the House, and to add about \$190,000,000 to its annual yield for the next two years, took definite form in the Senate Finance Committee today following a plea by Secretary Morgenthau for enactment of the full revenue program outlined by President Roosevelt in his message of March 3.

Mr. Morgenthau insisted that the Tax Bill must be built up to the full yield originally asked in order to repair the damage done to the budget by the Supreme Court's in-

validation of the Agricultural Adjustment Act and Congress's passage of the Bonus Payment Bill over the President's veto. These two measures, Mr. Morgenthau cited, have shot the prospective gross Federal deficit for the fiscal year ending June 30, 1939, to an all-time high of \$5,966,000,000.

But for these two actions, neither of which was contemplated by the President in charting the nation's financial course last January, the budget would yet be on the basis of declining deficits, which, as the President has repeatedly said, would furnish an adequate guarantee for the strength of the government's credit. With these two items satisfactorily accounted for by the pending tax measure, Mr. Morgenthau estimated that the deficit for the fiscal year 1937 would drop to \$2,675,700,000.

Needs \$495,000,000 For Two Years

The Secretary of the Treasury charged the whole cost of paying the bonus, estimated at \$2,237,000,000, to this year's expenditures, although the plan is to amortize the additional cost over a period of nine years at the rate of \$120,000,000 per year. The deficit for the fiscal year will, of course, be decreased to the extent that the veterans refrain from cashing their certificates, but it is not figured that this will be a substantial amount.

It was to finance the extra bonus cost and the new farm program, the latter requiring \$500,000,000 a year, and to make up the current deficit caused by invalidation of the Agricultural Adjustment Act and its processing taxes that the new revenue measure was required. As outlined today by Mr. Morgenthau, the need now is for a bill producing about \$495,000,000 annually, for the first two years and \$620,000,000 a year thereafter.

Mr. Morgenthau explained that the entire cost of the bonus had been added to this year's estimates of expenditures because the Treasury always anticipated the maximum in making its calculations.

"We estimate high on expenditures and low on revenues," he said.

Backs Profits-Tax Measure

Mr. Morgenthau repeated the President's recommendation that all of the new permanent revenues be provided by a new system of corporation taxes.

In line with this, the Treasury had praised the main provisions of the House measure—the new corporation tax based on undistributed income and the "windfall" levy to recoup at least \$100,000,000 in formerly impounded or uncollected processing taxes—but said it fell \$380,000,000 short of the revenues necessary to place the budget in the position it occupied prior to invalidation by the Supreme Court of the Agricultural Adjustment Act and enactment of the Bonus Payment Bill.

Mr. Morgenthau suggested, as did the President in his message, that the old agricultural processing taxes be revived to supply the tem-

Continued on Page Two

MOVE TO INCREASE YIELD OF TAX BILL

Continued From Page One

porary revenue. He did not, however, fully convince the Senate tax-bill framers that this was the best method.

Harrison Studies New Proposals

Chairman Harrison said he was not yet certain whether the Finance Committee would consider reviving the processing levies. Nevertheless, he pledged himself and his Democratic colleagues to work for the full revenue yield as asked by the President, indicating that if no other sources were found for the \$190,000,000 additional annual funds, the processing taxes might have to be revived. He added that he was working on other tax proposals which might supply the deficiency.

Secretary Morgenthau especially commended that part of the House's bill which revises the present corporate tax structure by substituting a levy based solely upon undistributed profits. This, he said, would meet a situation by which, according to Treasury estimates, more than \$4,500,000,000 of corporation income would be retired to surpluses during the present calendar year, with a resultant leak of \$1,500,000,000 in Federal revenues.

"With tax avoidance occurring on the scale indicated by the figures I have cited, I do not see how any increase in individual income rates or other general and continuing taxation could be justified until this leak in our tax system is stopped," said the Secretary.

Says All Will Be on Same Basis

Mr. Morgenthau made no recommendations as to the rates or as to the technical form by which the undistributed corporate profits tax should be applied.

"Whatever may be the debatable considerations that may enter into the preparation of particular schedules," he continued, "it will be well to bear in mind at all times that this is purely and simply a proposal to put all taxes on business profits essentially on the same equitable basis; to give no advantages and to impose no penalties upon corporation stockholders that are not given to and imposed upon the individual taxpayer who alone, or as a partner, derives his income from business profits."

It was toward the complicated rate structure in the House bill, however, that the Senators proposed to direct their efforts for simplification. An attempt will be made to do away with the complex tables approved by the House and also the division of corporations into two classes—those earning \$10,000 a year or less and those earning more than \$10,000—and to apply a simple schedule of five or six brackets.

It would be the purpose, too, to levy the tax directly on the amounts of net income withheld by corporations from distribution to shareholders, rather than express it in terms of the total net income.

No classification of corporations would be set up for rate purposes, under the changes which the Senators propose to attempt, but corporations of net income of less than a certain amount, say, \$50,000 annually, might be given an outright exemption from the new tax of \$1,000 or \$2,000, which they might withhold as undistributed profits.

Simplification Plan Sought

The prime movers in the effort to simplify the bill include Senators Harrison, La Follette, Connolly and other administration followers. In preparation for future action, Senator Harrison asked Secretary Morgenthau to submit a plan for simplification of the House measure, and especially for a shorter schedule of rates. He also asked for a plan and estimates in connection with the idea of allowing a limited exemption to corporations of small incomes.

Senator La Follette asked that the schedules be figured out as applying directly to the amount of income withheld by corporations from stockholders, and not to the total net corporate income as provided in the House bill.

Senate opposition to the new tax program was viewed today as continuing to decline. Senator Harrison gave evidence of that particular brand of confidence which he shows when positive that he is on the winning side.

"Why, with these few simplifica-

tions which we hope to get into the bill, the Senate will pass it without question," said the Mississippian. "I never was more confident of anything in my life."

The ease with which the measure was passed in the House went a long way toward melting prospective Senate criticism. The appearance today of Secretary Morgenthau and his associates, Guy T. Helvering, Commissioner of Internal Revenue, and George C. Haas, Director of Research and Statistics of the Treasury, was credited with keeping the opposition on the decline.

Mr. Helvering presented the same nature of argument which he previously had given to the House Ways and Means Committee. He suggested again that the main burden of the new corporate tax plan would fall on a limited number of corporations and individuals—7 per cent of the increase in taxable income would be received by individuals with incomes of more than \$25,000 and 5 per cent by those with incomes in excess of \$100,000—and that the revenue would come not from new taxes but through stoppage of leaks to present levies.

Mr. Haas took up certain of the objections raised against the bill in

the House, which are expected to be repeated by nearly three-score petitioners who have asked to testify during the Finance Committee's hearings.

Impressed by Morgenthau

Secretary Morgenthau's testimony had an obvious effect upon the committee members. The directness with which he testified and the quickness and definiteness with which he answered questions practically precluded any cross-examination; so much so that Republican critics quickly abandoned their plan to subject him to partisan fire.

Only a few questions were asked of the Secretary. One was by Senator Harrison, who wanted to know if the \$85,000,000 AAA floor tax refunds inserted in the bill by the House should be added to the deficit caused by invalidation of the AAA, estimated at \$517,000,000.

Mr. Morgenthau reached in a sheaf of papers before him and pulled out a sheet from which he read the answer. The floor tax refund, he said, should be added to the deficit and, furthermore, that it would require \$43,000,000 instead of \$25,000,000.

Senator King asked if the increased appropriations, voted and threatened by Congress for the army, navy, flood control and relief, had been taken into account in arriving at a gross Federal deficit.

Again Mr. Morgenthau reached into his papers and pulled out a sheet on which he had set down the deficit estimates for the present and next fiscal years.

"If it had not been for invalidation of the AAA and enactment of the bonus over the President's veto, the deficit for this year would be on a declining basis," the Secretary added.

"And we would not have had to pass a Tax Bill," put in Senator Harrison.

As to Estimates in Other Years

Senator Harrison asked if the record did not disclose that previous administrations had estimated their revenues too high.

Again reaching into his papers, Mr. Morgenthau exhibited a document which set out the revenue estimates and actual collections over a period of six years.

For 1931, the Treasury estimated revenues 15 per cent in excess of collections; 1932, 7 per cent in excess; in 1933, 13 per cent in excess, and 1934, 5 per cent in excess. For the fiscal year 1935, the first year's estimates for which he was responsible, Mr. Morgenthau said, the tables were turned and revenues exceeded the initial calculations by 4.5 per cent, and this year they were running about 1 per cent above.

The evident preparation which the Secretary had made for his appearance before the committee obviously disconcerted Republicans who were expected to cross-examine him. With the few questions as indicated above, he was excused.

In his prepared statement Mr.

Morgenthau made a special plea for enactment of a bill which would raise the full amount of revenue sought by the President.

"The Treasury has been able to borrow readily the amounts necessary to finance the recovery program and has been able to obtain these loans at steadily decreasing interest rates," he said.

"The continuance of this satisfactory situation, however, will depend upon scrupulous adherence to an orderly program looking to a balance of the Federal budget just as soon as the needs and abilities of our people make that possible and, thereafter, upon a steady reduction in the public debt.

"I sincerely hope," he said in closing, "that this committee will report to the Senate a bill giving effect, as fully as possible, to the President's recommendations of the amount of additional revenue needed to supply the deficiencies created since the budget message of Jan. 3."

Prepared by Oliphant in answer to
Sec'ys question that the tax bill
that it will work to advantage of big
corporations as against smaller ones.

It is argued against the proposed tax measure that it would definitely hinder the growth of business enterprise and further monopoly in that the small enterprise, which would otherwise have surplus with which to expand its business, would lose that surplus and be unable to expand its business because of distribution to stockholders. It is argued that in the past it has been by means of withholding distribution and keeping earnings that small businesses have been enabled to grow into larger ones. It is further contended that the proposed tax scheme would so crystallize the present setup that the large corporations would continue to be large whereas the small corporations would be unable to grow. This, it is claimed, is an evil.

In his statement to the Senate Finance Committee, Mr. Haas, on behalf of the Treasury, pointed out that in fact under the bill the small corporation is to be taxed much more lightly than the large one and that adequate opportunity is offered, from a tax standpoint, for expansion. There are also other answers to the contention.

Obviously the criticism proceeds from an assumption either that the stockholders in the small enterprise will not re-invest a substantial portion of the dividends received or that deduction of taxes will have the effect of crippling the small corporation and prevent it from having sufficient additional funds with which to expand. The latter assumption, in essence, is based on the notion that the Government should give a

subsidy to small businesses which they may use with the possible effect of becoming larger corporations. If it is desired to have a tax program based on taxation of enterprises by size rather than by income then such a proposal could be considered, and if the philosophy were acceptable a much more equitable and more carefully thought out plan could be suggested. But that is not the present tax policy of this country.

It is more to the point to consider the former assumption, namely, that stockholders will not re-invest. In considering this question it is pertinent to ask why stockholders would not re-invest or why they should re-invest. One may assume that the stockholders who have received dividends have spent part in the satisfaction of their personal wants and that they have the remainder left for re-investment. The former expenditure will go, in the long run, to increased demand and hence in a larger sense to re-investment in industry. The question, in the last analysis, is therefore whether the individual stockholder will re-invest the remaining portion of his dividends in the corporation which yielded them to him or prefer to invest it in some other enterprise.

Stockholders with dividend incomes available for re-investment are divisible into at least two general classes. The first class would consist of those active in the enterprise. They may be the largest stockholders or they may be the dominating stockholders, or they may otherwise have the enterprise at heart. In their case there will certainly be no difficulty in re-investing. Indeed, the very assumption must be, from a

realistic point of view, that they and "the corporation" which is seeking to expand, and which needs its earnings to do so, are essentially identical. The difficulty, if any, is therefore limited to the situation of the second general class of stockholders, namely, the passive ones whose stockholding is in the nature of a more or less casual investment. These stockholders must be persuaded that the enterprise in which their original capital was invested is a sufficiently worthwhile one to justify re-investment. Realistically viewed these passive stockholders are always lenders of capital who have been drawn into entrusting their money to the majority or dominating stockholders by the expectation (if not the representation) that they would receive substantial dividends on their investment. In practice, they have been treated as persons having a claim against the insiders but a less enforceable one than, say, preferred stockholders or bondholders have.

Certainly the very payment of dividends to the passive investors would be a motivation to re-investment since the money could not be more judiciously invested than in the very enterprise which had proved itself to be profitable. On the other hand, if the passive investor prefers to place his money in some other enterprise it must be because he is not satisfied or he has not been persuaded that that is to his best interests to keep it in the same place.

The people who assert that they will be hampered in the expansion of their businesses, must, in the last analysis, be the majority or dominating stockholders who resent either the necessity to persuade the

minority that their capital investment is being properly handled or who wish simply to avoid the payment of taxes on the accretion to their own, personal, total wealth, represented by investment in the corporation, which is largely due not only to their own investment but to the investment of the passive stockholders who in many cases represent in fact a majority of the total invested capital.

Even if it be conceded, moreover, that there will be a certain amount of hindrance to expansion on the part of small enterprises that will not be compensated for by the increase in purchasing power and by the exemption of the enterprise from the burden of corporate taxation, the question still remains whether the disadvantage to the particular enterprise is not outweighed by the advantages to the greater masses of the population, that is, by larger public policy. Among these advantages may be listed the following:

1. At present the insiders use their power to withhold declaration of dividends for selfish ends, *and at the expense of the federal revenues*. In many corporations we find that the decision of insiders to declare dividends is used for the purpose of selling long or short the stock owned by these insiders in their company. This is unfair to the remaining stockholders. A corporation which grows big by such devices is hardly a desirable one.

2. Often on the pretense that the accumulation is necessary to build up the financial condition of the company *and the Treasury loses* no dividends are declared. The effect is to depress the value of the stock to the passive stockholders

while the insiders rely on other income in the form of salaries from the corporation or in the form of income from outside sources. When the stock has been sufficiently depressed the insiders buy up enough from the non-dominating investors to yield a large profit when they proceed, after they have published their intention to declare a dividend, to unload to new "suckers." This widespread corporate evil would be much less under the proposed legislation, for dividends would have to be more regular.

3. The tendency of insiders is to consider all other stockholders as nuisances who were brought into the enterprise because of the money they contributed but who were neither to have a voice in the management of the business nor to have any definite claim to a return on their investment. It seems a definitely valuable social result of the proposed tax bill that insiders will have to take pains, after they have induced the hitherto passive investors to place their money in the enterprise, to persuade them that the corporation is sufficiently well managed to deserve re-investment of profits. This will keep management on its toes and will go far to removing many evils of corporate management which have actually kept corporations from healthy expansion.

4. Since dividend receipts must necessarily be re-invested in some enterprise, even if they are not re-invested in the enterprise in which they were earned, there will in the long run be a spreading of investment which may turn out to be more advisable. This will tend to keep not only stock prices but industries themselves more stable.

It has been assumed in this discussion that surpluses have brought about the growth of competing units that prevent monopoly. In fact, however, it is very much to be doubted whether the larger enterprises have ever grown merely from re-investment. In the ordinary run of things enterprises do not grow so spectacularly. The average enterprise, if it is a profitable one, tends to be modest — otherwise we should have more and more breakdown in competition. The successful enterprise which grows into a Chrysler Corporation or a General Motors (even if not a Ford) is typically one which is either the result of integration with others or one in which outside capital is induced to invest after the business itself has demonstrated its possibilities. Underwriters and banking houses serve that function in the financial world. The additional capital which is necessary to make large businesses of the Chrysler type is obtained either through bond issues or through very large stock issues; typically it is not made merely through keeping surpluses in the business.

Furthermore, the surplus which is kept in the business is determined by what the people who dominate enterprises keep in after they have taken out enough for their own personal wants commensurate with the standard of living to which they think they are entitled. In such cases it is not the smaller investor who contributes to spectacular growth of enterprises.

It must be concluded that businesses which cannot induce re-investment of dividends available for re-investment are mainly businesses which

are managed or dominated by persons who wish to compel unwilling partners to continue in enterprises in which these partners do not believe. There is no social advantage in lending through the taxing power a further governmental hindrance to the unwilling partner's desire to get out of the partnership to the extent of the profits realized on the venture. It is enough that the courts and the laws compel him to keep invested the capital he originally threw into the enterprise.

Finally, it should be pointed out that there is nothing to indicate that the relatively small vigorously growing businesses do not now have reserves relatively as great as the giants of industry. How much reserves any corporation has is, in final analysis, merely a question as to the percentage of its solvency, ^{For} ~~where~~ the mass of business, probably the relatively smaller units, are solvent ^{to} ~~at~~ quite as high, if not a higher, percentage as the large ones.



TREASURY DEPARTMENT

WASHINGTON

May 2, 1936.

MEMORANDUM TO SECRETARY MORGENTHAU

In Re: The Burden on Small and
Large Corporations under
the Tax Bill.

I have not had time, of course, to examine this question in any detail. It seems, however, that from one way of looking at it the large corporations will pay out less in taxes as corporations under the new bill than they did before, assuming that they make no change in the proportions of their earnings which they distribute annually. I learn that a study made over at the Federal Reserve Board shows that the large non-financial corporations reporting net income in the period 1923 to 1929 paid out in dividends some fifty-seven per cent of their net earnings after taxes. Under the House Bill they would pay fourteen and one-fourth per cent on their net earnings before taxes if they continued to pay out this proportion of their earnings in dividends.

Under the present Act they pay about sixteen per cent. This looks as if the new bill favors the large corporation. Actually, however, under the new bill there will be an inducement to the large corporation to distribute its earnings which does not exist under the present Act. As the purpose of the bill is not to increase the taxes on the corporations, but to increase the tax revenues to be derived from the income earned by corporations through the personal income tax, this is really irrelevant. The shareholders will exercise some pressure on the corporation to distribute its earnings, on the ground that otherwise the corporation would be subject to a tax from which it can escape through distribution of earnings. Under the present law, no such means of escape exists and therefore, under the present law there are no tax inducements to distribution of earnings, while there are important tax incentives to non-distribution.

It seems to me, therefore, that the proposed bill is to be appraised not in terms of the comparative tax burdens on a corporation under the old and under the new tax measures if that corporation adheres to its former practice with respect to distribution of earnings, but on the basis that the new measure puts pressure on the corporation to distribute its earnings by increasing the advantage to the shareholders, unless they are very wealthy, of such distribution.

Jacob Viner

COPY

May 2, 1936

MEMORANDUM TO SECRETARY MORGENTHAU

FROM: JACOB VINER

In Re: Negotiations with China

I take it that the Treasury objectives are:

1. A currency system in China satisfactory to herself.
2. As much absorption of silver by China for currency and other purposes as is consistent with (1) above.

The Treasury, as I understand it, is prepared to undertake the purchase of surplus Chinese silver at the market price, provided the purchases are spread fairly evenly over an extended period of time and provided the Treasury is left with discretion as to the precise timing of the purchases. I understand also that the Treasury is willing to undertake to give China a credit against silver deposited as collateral, against which credit China can draw when and if she needs dollar funds in greater volume than sales of silver at the scheduled rate would provide.

If these assumptions are correct, then it seems to me that the negotiations, as recorded in the file, are progressing favorably for both countries. The only comments I feel that I have to make are - first, that China should be advised to value her reserves at their actual market value, rather than at any artificial valuation. The fact that we follow a different practice should not be made the basis for urging similar foolishness on the part of other countries. Second, the Chinese apparently do not wish to peg to the dollar and we are obviously not anxious that they should peg to sterling. It seems to me that the best solution, which gives the Chinese the advantage of pegging and at the same time frees them from the charge by us that they have pegged to sterling or by the English that they have pegged to the dollar, would be for them to peg to a mean rate between dollar and sterling. Of course, this could work satisfactorily only with a certain margin of variation so as to avoid awkward fractions in the sterling and dollar exchanges, and would work very badly if the dollar and sterling should begin having marked variations relative to each other. But as long as the dollar and sterling are relatively stable in terms of each other, this seems to me to be the most satisfactory procedure for the Chinese.

May 4, 1938

At the 9:30 meeting this morning, the Secretary again inquired whether the tax bill would not be pretty severe on small and medium-sized corporations by preventing them from building up surpluses. Haas justified the provision in the pending bill by pointing out that corporations pay out dividends and offer to their stockholders "rights" to subscribe to stock and the stockholders in turn pay in their dividends and get more stock. HM, Jr. was of the opinion that stockholders in small corporations would not do that and cited instances of a few small concerns in Poughkeepsie where the stockholders receive their dividends and spend the proceeds but do not subscribe for rights.

HM, Jr. also inquired concerning the loop-holes in the bill which, if not plugged, would result in loss of revenue to the Treasury. The loop-holes are ways by which taxpayers and corporations can avoid paying the tax. Oliphant expressed complete confidence in McLeod's estimates. Upham, however, feels that McLeod's estimates are based on the supposition that the loop-holes have been plugged. HM, Jr. inquired of Mr. Upham who were the men on the Hill who had raised the question about loop-holes and Upham replied that Beaman, of the House Legislative Counsel, O'Brien, his assistant, and Mr. Kent of Internal Revenue are the fellows who have the information. Oliphant said he would get in touch with the three of them and talk it out.

May 4, 1936.

Secretary Morgenthau

Mr. Herman Oliphant

After the morning meeting on the tax bill, worked on Harrison's suggestion of two slight changes to enable him to have the bill reported favorably.

With Upham and Kent, saw Beaman, Parker and other legislative experts at and after lunch to make a recheck on possible loopholes. I might say that our own experts on this are Messrs. Turney, Kent and Lusk, and possible loopholes have occupied most of their time since March first.

Turney and Kent confirmed my statement this morning that all major loopholes have been plugged, and there remain only those miscellaneous minor possibilities of avoidance, possibilities which we always have in the case of any general tax bill.

My recanvas of possible escapes with Beaman, Parker and O'Brien was not completed because of a special matter I shall mention below; although on general inquiry they referred only to Section 27(i) relating to intercorporate dividends which will have to be reworked because of the last minute amendment in the House making the dividend year the same as the taxable year.

Instead of Harrison's suggestion of a flat exemption of \$2,000 for corporations with net incomes of less than \$20,000, Parker suggested that we adopt one table (that with the higher rates), let corporations figure their tax under it, and then tax corporations with incomes of less

-2-

than \$15,000 or \$20,000 that fraction of the tax so calculated which their income is of \$15,000 or \$20,000. Much time was spent discussing this possibility of meeting Harrison's request for simplification, and it looks promising. George and I worked on it some this afternoon, and it looks as if it might be adopted without any loss of revenue.

I might add, generally, that having gone through this whole process in the preparation of the Revenue Act of 1934, and the Revenue Act of 1935, and knowing how our own staff and the two staffs on the Hill work, things are moving and are being handled in the usual way, and, as usual, the process of perfecting the bill will continue until final enactment.

Dr. Feis called me about a cablegram from Flack relative to the transfer of Brenner in Waite's office in Paris to Boston. I relayed the message to Gibbons as Feis requested.

/s/ HO
Mc

COPY

C
O
F
F
Y
TREASURY DEPARTMENT

Washington

May 4, 1936.

MEMORANDUM FOR THE SECRETARY:

Further conferences occurred this morning between representatives of the Canadian distillers and representatives of the Treasury Department and the Department of Justice, with the following results:

Consolidated Distillers

Mr. Forsythe, for Consolidated Distillers, made an offer to settle the Government's claim (amounting to \$4,527,982.08) for the sum of \$237,500, this to be liquidated in installments. To secure the payment of this amount, Mr. Forsythe offered to pledge with the Government certain stock owned by his company in a company known as Distilled Liquors Corporation. This stock is carried on the books of Consolidated Distillers at a value of \$114,000, but has a nominal market value of \$10 a share, or \$237,500. Payment would be made according to Mr. Forsythe's proposal from time to time as the stock in question should be disposed of by Consolidated Distillers, the Government to assume the loss for any sales which might occur at a price lower than \$10 per share. Additional payments would be made at the rate of 16 cents per gallon on all importations of the company's liquor into the United States until settlement had been made in full.

Mr. Forsythe was advised by the Government's conferees that his offer was unacceptable.

Mr. Forsythe stated that this was the final offer which could be made by his company. He stated, moreover, that he was not in a position to make any offer which would involve submitting his company to the jurisdiction of the United States courts and posting security to pay any judgment which the Government might obtain after litigation.

Mr. Forsythe was requested, and agreed, to submit the proposals which he had made in written form.

In the course of this morning's discussions, Mr. Forsythe stated that the controversy over the settlement of the Canadian distillery claims had now become an important political issue in Canada, and that he had no doubt that if the proposed legislation should be enacted it would result in breaking down the Canadian Trade Agreement. He went

Memo. for the Secretary - 2.

on to say that the Prime Minister had already announced that in the event the legislation were enacted, it would be necessary for Canada to have recourse to the "escape clauses" of the Agreement.

Seagrams

Mr. Phillips, on behalf of Seagrams, who, as you have previously been advised, had earlier made an offer of \$500,000 in settlement of the Government's claim, which offer was rejected, offered on alternative No. 2 to furnish security for the payment of any judgment which the Government might obtain against his company in the form of a surety bond for \$750,000. He qualified this by saying that he would be willing to increase the bond to \$1,000,000 provided the amount could be related to the current imports of Seagram whiskey into the United States at a fixed rate per gallon.

Mr. Phillips was advised that his offer was unacceptable. In this connection, his attention was called to the fact that Mr. Seth Richardson, Washington attorney for his company, had advised the Senate Finance Committee that the company would be willing to post a cash bond in a larger sum than Mr. Phillips' present offer. His attention was called also to the fact that he himself at an earlier conference had suggested that his company would probably be able and willing to furnish a surety bond in an amount of, as he said, two or three million dollars. In other words, it was pointed out to Mr. Phillips that his final offer in the matter of security made to-day was substantially less than previous offers which had been made, at least tentatively, on behalf of his company.

Inasmuch as Mr. Phillips' offers, as he was told, were unacceptable to the Government, and inasmuch as he had made it clear that these were the final offers which would be made, he was advised that there would be no purpose in further meetings, and that so far as the Government was concerned the matter was regarded as concluded.

Mr. Phillips was requested to submit his offers in writing. He did not agree to do so.

RECOMMENDATION

It is the opinion of the Government's conferees (1) that the negotiations with the Seagram Company have definitely broken down; (2) that Hiram Walker has no intention of undertaking to work out an agreement with the Government; and (3) that unless substantial concessions are made, no agreement is possible with Consolidated Distillers.

You will recall the following provision in the Department's memorandum of April 10, which was agreed to by the State Department:

Memo. for the Secretary --3

"5. If negotiations with the companies carried on in accordance with the foregoing should be fruitless as to any one of the following companies, namely: Distillers Corporation--Seagrams, Hiram Walker--Gooderham and Worts, Consolidated Distillers, and United Distillers, the Treasury Department and the Department of Justice will be free to proceed with the legislation."

Inasmuch as the negotiations have proved to be fruitless with the Seagram Company, and without regard to the status of negotiations with the other companies, it is the opinion of the Government's conferees that the legislation pending before the Senate Finance Committee should be proceeded with at this time in accordance with the understanding had among the three Departments at the time the negotiations were begun; and that recommendation should be made accordingly to the Chairman of the Senate Finance Committee by the Secretary of the Treasury and the Attorney General.

GRAVES

May 1, 1936

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

At the group meeting ^{my} asked the question whether the provision in the pending tax bill which places a tax on undistributed earnings is fair to the small business man. He said no one had convinced him that it was. He said, Ordinarily, big corporations are a handicap to the little fellow. Will this be an additional handicap to the small dealers? He turned to Haas and said, "If there are answers to this question, three cheers! But if there are not, let's be big enough and correct it. The pride of authorship is not the important thing if it is going to hurt small business." He added, "I have not had an answer to my question from anyone."

May 1, 1936

Dr. Viner came to Washington today from Chicago. The attached memorandum, in HM, Jr's handwriting, lists the things the Secretary wants Viner to do while he is here.

John Viner
Study China Libre
Mexico Libre

chart showing
price levels -
his interpretation
of our price level
in relation to
other countries

any suggestions
in case Frank
bevalnes



TREASURY DEPARTMENT

WASHINGTON

May 2, 1936.

MEMORANDUM TO SECRETARY MORGENTHAU

In Re: Mexican Negotiations.

There are two points in the Mexican memorandum which call for attention.

First, on page 2, paragraph d, the Central Bank "would be authorized to acquire silver up to twenty-five per cent of its gold and foreign currency in stock, plus fifteen million pesos additional". This would make the twenty-five per cent ratio a maximum, with no obligation on the part of the Central Bank to hold any silver whatsoever as a reserve. What you would want presumably is that the twenty-five per cent should be a minimum.

Second, the memorandum ends on the theme that "the Government of Mexico looks forward to securing a price considerably higher than those prevailing today in the international markets". I see no reason why we should encourage them in this aspiration. Mexico is profiting sufficiently from the fact that we are providing a market for their silver at an artificially high price to make it altogether unreasonable on their part to ask us to pay still more. Aside from these two points, it seems to me that the Mexican arrangement is along satisfactory lines, leading to some absorption of silver by Mexico herself and reasonable cooperation with Mexico in establishing a currency system suitable to her needs.

Jacob Viner

May 4, 1936

Mr. Thomas L. McCarter, of New Jersey, saw the Secretary today. He said the holding companies would like to get rid of the subsidiary companies, but they are balked by the provision in the 1935 Tax Act. He would like to see that Act amended so as to reasonably eliminate the difficulties of taxation on mergers.

HM, Jr. suggested that he incorporate his views in a memorandum and send them to him personally, in care of Mrs. Klotz, and he would have our General Counsel study them.

PUBLIC SERVICE CORPORATION OF NEW JERSEY

Public Service Terminal

80 Park Place
Newark, N.J.Office of the
President

May 5th, 1936.

My dear Mr. Secretary:

Yesterday I explained generally the situation of our Company. I stated that we were very desirous of simplifying our corporate structure. I pointed out that our sympathies all lay in the direction of simplification. I then stated that some method should be provided under which the simplification of corporate structures could be brought about without risk of unbearable and unknown tax liabilities.

Section 112(b)(6), which was added last year to the Revenue Act of 1934 by section 110 of the Revenue Act of 1935, was adopted by the Congress to facilitate simplification of corporate structures. In general principle, the section meets with my full approval. However, two technical difficulties are encountered in its application:

First, the section requires the ownership of 80 per centum of each class of stock. In our case this is quite impossible. We do own more than 80 per centum of all the voting stock of our principal subsidiary, but one class of preferred stock is in the hands of the public and has been for years. It would seem to me adequate if the parent company owned, for example, 80 per centum of all the voting power in the subsidiary. Certainly the result to the parent upon the merger of its subsidiary is identical. All the properties of the subsidiary will go to the parent. None will be distributed to the outside stockholders. Likewise, it would seem to me that the Government would be adequately protected, and certainly as well protected as under the present law.

Second, I am advised that, under the present law, the properties of the subsidiary when transferred to the parent would be given an entirely new basis upon which depreciation is to be computed. The law requires that the existing basis, which has been established only after many years of examinations and conferences with the Bureau, be abandoned; and that a new basis be prepared through a method of allocating to the properties some percentage of the cost to the parent of its stock in the subsidiary. Our accounting officers advise me that this allocation is not only most difficult and complex, but can not be made with any degree of certainty. It would seem to me that both simplification and

safety would require that depreciation of a subsidiary's properties continue on exactly the same basis after the liquidation as it did before.

With these two technicalities of the present law removed, I am confident that we will be in a position to bring about a most desirable simplification of our corporate structure, and I would assume that many other corporations are in a similar situation.

I have asked our General Counsel to prepare appropriate amendments to carry out the policies I have suggested. They are as follows:

Amend the first sentence of section 112(b)(6) to read as follows:

"No gain or loss shall be recognized by a corporation upon a statutory merger or consolidation with another corporation, if the corporation is the owner of voting stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote (whether or not such merger has the effect of a liquidation of such other corporation), or upon a complete liquidation of such other corporation."

Insert an appropriate provision in section 113(a)(6) so as to exclude therefrom a transaction described in section 112(b)(6).

Insert an appropriate provision in section 113(a)(7) so that this section will include a transaction described in section 112(b)(6).

I appreciated very much indeed the sympathetic consideration you gave to the problem I discussed.

Very truly yours,

(Signed) Thomas N. McCarter,

President.

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

May 4, 1936

HM, Jr. was very much annoyed at Haas for not looking out for his men. McLeod broke down physically because of overwork and HM, Jr. felt that it was up to Haas to see that nothing like that happened in his Division. Mr. Morgenthau said that rather than have anything like that happen in the Treasury, he would rather ask Congress for an adjournment. He said that he personally looks after the heads of the various Divisions with whom he works closely and he expects the head of each Division to look after his subordinates.

May 4, 1936

HM, Jr. said the President called him at Fishkill in regard to appointing a man by the name of Truitt in place of Jackson. Truitt is Solicitor for the Reconstruction Finance Corporation. Oliphant told the Secretary he did not think well of this appointment at all and would send HM, Jr. a memorandum. (Copy of memorandum attached.)

(This applicant was endorsed by Jerome Frank in a letter, dated April 9, addressed to Mr. Edward Greenbaum and sent to the Secretary by Mr. Greenbaum. Copy attached.)

May 4, 1936

Secretary Morgenthau

Herman Oliphant

In re: Max O'Rell Truitt, Solicitor of Reconstruction Finance Corporation, for position of Assistant General Counsel for the Bureau of Internal Revenue.

Through Willcox and Harlan I have been able to get the following information about Truitt.

He is from St. Louis and is about 38 years old. Attended one of the local law schools and is married to Senator Barkley's daughter.

Snodgrass, who holds a high position in the legal staff of R. F. C. and who works very close to Truitt, makes the following confidential statement to Willcox about him: "When he thought of leaving, one of his former partners urged Jones to keep him in Washington 'for the good of the R. F. C. and the firm.' He is something of a busy-body, creating work for himself - conscientious, but not 'too wide between the eyes' - a pretty good trader - apt to start things he can't or doesn't finish. He has thrown several monkeywrenches, and the directors would vote a leather medal to anybody that took him away from the R. F. C."

Jim Alley, General Counsel of R. F. C., told Harlan confidentially that he is a very mediocre type of lawyer; the position he holds is one which was created to take care of him, and, he will be very glad to have us take him off his hands.

(Signed) Herman Oliphant

JGH-hbk

COPY

Washington, D. C.
1016 Interior Building.
April 9th, 1936

Mr. Edward Greenbaum,
C/o Greenbaum, Wolff and Ernst,
285 Madison Avenue,
New York, New York.

Dear Eddie: PERSONAL AND CONFIDENTIAL

The suggestion has been made in certain quarters that Max Truitt be named as successor to Bob Jackson as General Counsel for the Bureau. Max is now Solicitor (not General Counsel) for RFC. Confidentially, his life over there has not been an altogether pleasant one, because he has refused to be a rubber stamp for the Chairman; I am making this statement because his relations to the Chairman might be a matter of interest to the Secretary.

I have worked with Max on many matters, and particularly in connection with the Missouri-Pacific - Van Sweringen matters. He is an excellent lawyer, and has admirable common sense and poise. I have seen him handling his administrative activities, and there he functions beautifully; he knows how to guide and counsel his numerous assistants, and how to keep the work moving. His integrity is beyond question. He happens to be the son-in-law of Senator Barkley of Kentucky. He is a good friend of, and highly regarded by, Stanley Reed. I think he would be an ideal man for the job.

Yours sincerely,

(Signed) Jerome
Jerome N. Frank.

P.S. He is a liberal conservative.

May 4, 1936

HM, Jr. told Gaston and Mrs. Klotz this afternoon that over the week-end the thought came to him that he might like to go on the air on the night of Sunday, June 14, and say something like this: This is the night of June 14. Fifty weeks out of the 52 weeks of this fiscal year have passed. Let us take a look at the deficit as it is tonight. What did the President say it would be? Going today on the assumption that the deficit at the end of 50 weeks of this fiscal year will be less than it was the previous fiscal year (and at the same time I want to say that tomorrow we add to the books of the Treasury \$2,300,000,000 for the bonus) that up to tonight the President has lived strictly within his budget message and has done what he said he would do.

The Secretary met Mr. Paley, of the National Broadcasting Company, and Mr. Paley told him that it was about time he made another radio speech and HM, Jr. took occasion at that moment to tell him about the thought he had that he might want to go on the air on June 14th. Mr. Paley said that Jim Farley was scheduled for June 14 to speak on the bonus, but that they would put him aside if the Secretary really wanted to talk.

HM, Jr. checked this with Steve Early, who said he thought it was all right, but that HM, Jr. ought to be sponsored by someone rather than have it look as though he was asking for the chance to talk. HM, Jr. told Steve Early that he was not running for office and there was nothing that he really wanted, but that if he did talk at all he would do so feeling that it was good for the President.

The Secretary asked Gaston to see the three broadcasting stations and try to arrange an hour for him. He said he does not want to give it to any one company alone.



DEPARTMENT OF STATE
WASHINGTON



May 4, 1936.

My dear Mr. Bell:

Mr. Hackworth and Mr. Pasvolksy have told me of the extremely interesting conference which they had the other day with you and your associates. I am glad that it was possible to arrange this useful exchange of views.

In accordance with your request, I enclose here-
with a brief memorandum on the "Policy Aspects of
Proposed Treasury Action Under Section 303." While
the statement is necessarily somewhat rough, it contains
what we believe to be the essential considerations
involved.

Sincerely yours,

Francis B. Sayre
Assistant Secretary

Enclosure:
Memorandum.

The Honorable
Golden W. Bell,
Assistant Solicitor General,
Department of Justice.





Department of State

BUREAU
DIVISION

TA

ENCLOSURE

TO

Letter drafted

5-2

ADDRESSED TO

The Honorable
Golden W. Bell

DEPARTMENT OF STATE
DIVISION OF TRADE AGREEMENTS
MEMORANDUM

May 1, 1936.

POLICY ASPECTS OF PROPOSED TREASURY ACTION
UNDER SECTION 303

1. The German practices against which the Treasury contemplates the imposition of countervailing duties arise out of the foreign exchange control operating in that country. They should, therefore, be appropriately regarded as currency measures, constituting special forms of currency depreciation. This nature of the practices in question is entirely clear in the case of blocked marks, ASKI marks, and barter transactions. The scrip procedure, although somewhat more complicated, is of the same general character. The bond procedure is more of a borderline case and may conceivably fall outside the sphere of purely currency measures.

2. Currency manipulation of the general type used in Germany is employed by a number of other European countries and by several countries in South America. If it is decided to invoke Section 303 against Germany, it is difficult to see how the Treasury can fail to invoke the provisions of that Section against the other countries employing the same practices.

3. The

- 2 -

3. The invocation of penalties against currency procedures which involve partial depreciation is bound to cause ill-feeling and is likely to lead to retaliation, especially in view of the fact that no punitive action was taken by foreign countries concerned against the depreciation of the dollar and the other currency measures adopted by us.

4. Treasury action under Section 303 against such South American countries as Argentina, Brazil, Chile, and Uruguay, which employ multiple currency systems essentially similar to that of Germany and against which countervailing action would logically become unavoidable once it is taken against Germany, would be particularly unfortunate in view of the approaching conference at Buenos Aires.

5. In addition to the ill-feeling that it would generate, countervailing action against currency measures would result in substantial injury to our export trade. There appears to be no doubt that Germany is experiencing at the present time genuine difficulties in procuring dollar exchange with which to pay for her imports from the United States. Her purchases from the United States, particularly of agricultural products and certain raw materials such as cotton, fruit, tobacco, lard, lumber, petroleum, and copper, have already been greatly reduced.

Such

Such trade as still exists has been made possible mainly by the employment by the German Government of special currency arrangements. The imposition of countervailing duties on a long list of German goods because of such arrangements would, of course, reduce our purchases of German goods and thus lead to a still further loss in our sales to Germany. The same considerations apply to the other European countries employing currency manipulation and to the South American countries named above.

6. There is no evidence that imports from countries with multiple currencies are marketed in the United States on such terms as to compete unfairly with similar domestic products. The currency procedures employed appear to be designed primarily to overcome the price and foreign exchange maladjustments resulting from the depreciation of some currencies, including the dollar, and failure on the part of the countries employing multiple currencies to effect a complete depreciation of their currency units.

7. It appears clear that the imposition of countervailing duties against Germany is not necessary as a safeguard for our producers, but would cause a definite injury to our exporters. Moreover, such action would result in the creation of new barriers to trade and would, therefore, run directly counter to the purpose of our
trade

trade agreements program, which is designed to bring about a reopening of foreign markets for our burdensome surpluses through a reduction of trade barriers.

RECEIVED
10 1 19 11 01
BUREAU OF REVENUE
CALIF

Monday
May 4, 1936

HMjr: Cochran?

H. M.

Cochran: Yes

HMjr: Good morning

C: Good morning, sir

HMjr: Did you go away over the weekend?

C: No, because my friend was still in Berlin.

HMjr: I see.

C: And I would have had to gone there for Saturday morning.

HMjr: Yes

C: And we had conferences with the leader that morning.

HMjr: I see.

C: And - the leader from that little place -

HMjr: Yes

C: Now -

HMjr: Now, Cochran -

C: I'd better wait here now and see him when I go to Basel this week-end.

HMjr: That's all right.

C: Yes

HMjr: Now, Cochran -

C: He has the right dope on that situation.

HMjr: Do you mean on the election?

C: No, I mean on - on our neighboring country and on the Doctor.

HMjr: How do you mean?

C: That the appointment of the big fellow, you know, the military man - ?

HMjr: Yes

C: is in accord with the Doctor's wishes.

HMjr: Does what?

C: It's in accordance with the Doctor's wishes.

HMjr: Oh, it is?

C: It strengthens his position for the present.

HMjr: What is that?

C: And I say it really strengthens the Doctor's position at present.

HMjr: Just a minute - I see.

C: And I don't think anything there is likely to happen now.

HMjr: Well, we'll wait until you - over the week-end - - next week-end.

C: I'll be going down to Basel probably Friday night.

HMjr: All right, now -

C: It's still quiet down here -

HMjr: Yes

C: Thursday night

HMjr: O. K.

C: - Otherwise not until Friday night.

HMjr: Now, Cochran -

C: Yes

HMjr: We're getting an awful lot of gold today.

C: Yes, I know -

HMjr: And --

C: - a telegram at one o'clock.

HMjr: Yes, well what was the - what's the situation right now?

- C: Well, I just talked to the Guaranty man who loaned us some nine billion dollars -
- HMjr: Yes
- C: At half past twelve the National City had done twelve million over five million - the National City.
- HMjr: Yes
- C: And some other people working - and I talked to our particular friend, you know, at the bank, Cariguel?
- HMjr: Yes
- C: He told me that private banks were taking care all right of the demand for dollars.
- HMjr: Yes
- C: They raised the quota of this bank so the turn-over is tremendous.
- HMjr: Now, of course you know the English have let sterling run up?
- C: Yes, it's - the paper down there, you see?
- HMjr: Yes
- C: Many of our people could not liquidate theirs.
- HMjr: Are they very nervous?
- C: They're a little nervous here, yes.
- HMjr: Well, now -
- C: There are rumors on the market that the Governor and some of the more conservative regents of the bank may resign.
- HMjr: Yes
- C: And then there are various rumors that the present Government likes this situation for a day or two and if that will continue this Government will give out a statement on the gold embargo.
- HMjr: When does the Cabinet meet, Wednesday?
- C: Tomorrow -
- HMjr: Tuesday?

C: Yes, Tuesday -

HMjr: Well, they meet - the Cabinet meets Tuesday? - Hello?

C: Yes - yes

HMjr: Do you think that they'll stay on until June 1?

C: It's absolutely difficult to say. This man wants to stay on -

HMjr: Yes

C: Just a little more now and then he would stay on and if any drastic action must be taken, he wants to take it -

HMjr: Yes

C: Rather than sympathize and let Reynaud do it.

HMjr: Yes

C: I mean that's the way it looks today so far.

HMjr: I see.

C: Still too early to say, but -

HMjr: Well, now -

C: I this all myself and I sent you one wire and I'll send you another one this evening.

HMjr: Well, now Cochran -

C: Yes, sir

HMjr: If anything very important happens use the telephone.

C: All right.

HMjr: If something very important.

C: Well, surely if I ever get any word about embargo -

HMjr: Yes

C: Or a resignation of this Government -

HMjr: Yes

C: I'll see that you get it.

HMjr: Yes, use the telephone because the Cable service is too slow.

C: Surely - well, this morning I just summarized the election and the gold movements up until one o'clock.

HMjr: Yes

C: And so I'll get in touch with the other people this afternoon.

HMjr: O. K. - Thank you - goodbye.

C: Goodbye.

May 4, 1936

Dr. Tugwell and his assistant, Mr. Baldwin, and Mr. Bell met with the Secretary today.

The following is stenographic report of the meeting:

HM, Jr.: Before we get down to actual figures, let me just tell you what's going through my head. Either today, or tomorrow or the next day, Dan and I are going to have a pistol put to our head -- at least I think so -- by the President and by Hopkins, because I don't think Hopkins has enough money. I want to tell you everything I have in my mind. I think that is always the best way. That's one problem. And Dan and I have to make up our minds whether this idea of setting up projects, setting up money

Dr. Tugwell: That's worried us, because already we are 20 or 30 millions off on that.

Mr. Bell: You mean in the hole?

Dr. Tugwell: Sure! You know that. And that's serious.

HM, Jr.: Whether we are going to do it or not, I don't know. Whether we are going to be ordered to do it, is something else. Up to now, the President has thought that when you start something you ought to have enough money there to finish it. The pressure is getting more and more each day. How much is Hopkins up against it?

Mr. Bell: Within the next week he's going to be up against it in certain sections.

HM, Jr.: It will take me a little while to get around to the point.

The question I want to ask is this: I haven't got an exact figure, but I think it is something like 40 or 50 millions to buy land, from various appropriations.

Mr. Baldwin: About \$48,000,000.

HM, Jr.: Of which I understand you claim it is all obligated?

Dr. Tugwell: Yes; all obligated.

-2-

HM, Jr.: I also heard what the President said about complaints. I don't make any investigation of anybody. You know that.

Dr. Tugwell: I don't care whether you do, Henry.

HM, Jr.: I have had no investigations made. There are a lot of things which I don't know, if I seem to go around backwards. Why shouldn't Soil Conservation purchase the land -- why shouldn't that whole thing be under Soil Conservation in the Department of Agriculture?

Dr. Tugwell: Well, I don't know. Maybe it should.

HM, Jr.: The \$500,000,000 that they have for Soil Conservation and all the Soil Conservation work they are doing -- why that should not be in there? I am thinking of the Department of Agriculture.

Dr. Tugwell: We want this thing moved up to the Department of Agriculture and there is a bill up there to that effect -- that's the Farm Tenant Act.

HM, Jr.: Any chance of that passing?

Dr. Tugwell: I don't know.

Mr. Bell: There really isn't any chance?

Dr. Tugwell: I don't think so. Of course, you understand that while Soil Conservation Service does all of its work on private lands, it does not do any on public lands. And you understand that Soil Conservation of AAA just pays benefits for planning better soil for crops, but this takes land out and puts it into the public land.

HM, Jr.: Perfectly frankly, I feel this very strongly and I haven't gotten anywhere on it up to now, that to take what I said is money which was supposed to be for relief purposes and buy land, it has never gotten down so dramatically that it is a question now of whether we should take care of people on relief or whether we should buy land.

Dr. Tugwell: I supposed that question was answered a year ago when the President told us to do this. You understand, it has been going on for a long time -- since the spring of 1933.

-3-

HM, Jr.: Where did it start?

Dr. Tugwell: It started in Interior, moved to Hopkins and transferred to us. I think if you saw the operations of the thing, you would realize that it is one of the best. You understood, we pay less than \$4.00 an acre for this land. That's the average. There is some high-priced that was given for recreation purposes, but, you see, people were taken off these lands and resettled.

HM, Jr.: Where are they resettled? How much of that actually happened. How many families?

Dr. Tugwell: I could not tell you, because we do most of it by loan. We give them a Rehabilitation loan. We buy land and if they have an equity, they resettle themselves, but if they don't, we give Rehabilitation loan to settle them somewhere else or go through the Resettlement phase, which is a much longer process. About 15,000 families.

HM, Jr.: Unfortunately, when I had the time to be interested exclusively in agriculture, I have never seen it successfully done. That does not mean it can't be done.

Dr. Tugwell: I think that's right.

HM, Jr.: But I have yet to see -- whether you take families off the hill tops and try to move them somewhere else -- it wasn't done successfully in New York State anyway. The President moved 1,000 families out of Syracuse

Dr. Tugwell: I think that's another kind of thing.

HM, Jr.: But unfortunately I have never seen it done.

Dr. Tugwell: We have a couple of hundred thousand cases where it has been done successfully, in this sense. They have begun to repay back their loan and have supported their families on the place.

HM, Jr.: I thought you said 15,000 families.

Dr. Tugwell: You have to distinguish between Rehabilitation loans and actual Resettlement where we buy the land and resell it to them.

HM, Jr.: You have \$48,000,000 to buy land and I take it that is all for Submarginal land?

Dr. Tugwell: That is right. Yes.

HM, Jr.: Then you have other money with which to buy good land?

Dr. Tugwell: Yes.

HM, Jr.: How much?

Dr. Tugwell: I don't know; that comes in as part of the project.

Mr. Baldwin: We have already, or will buy about 15 or 16 million dollars.

Mr. Bell: Is that in your Rehabilitation program?

Mr. Baldwin: That comes out of the \$91,000,000.

HM, Jr.: But the \$48,000,000 is exclusively for buying Submarginal land?

Mr. Baldwin: Yes. The program was originally a \$114,000,000 program. We actually had \$78,000,000 at one time and now we are down to \$48,000,000.

HM, Jr.: And now I am trying to take some of that?

Dr. Tugwell: True, I don't think you can because options are already accepted.

HM, Jr.: But you don't mind my challenging that in a courteous manner?

Dr. Tugwell: No.

HM, Jr.: I don't understand it but I would like a lawyer to do it for me. But I can't get it through my head. We asked for 4 billion \$. The President intimated that about half of it would be returned to the Treasury and if we get 5% back we are lucky.

Dr. Tugwell: You understand, most of that did not come out of the 4 billion \$.

Mr. Baldwin: The \$48,000,000, you mean?

HM, Jr.: But I can't get this thing through my head. It is not for Parks.

Mr. Baldwin: Parks, Grazing Areas, Reclamation Areas. We have 60 thousand men working now and as soon as we get it developed we will turn it over to the proper officials.

HM, Jr.: You have the CCC camps?

Dr. Tugwell: Some.

HM, Jr.: But these are not lands that are being bought for the CCC. That is another land program.

Mr. Bell: This is a part of it and the Forest Service has some.

HM, Jr.: How much have they?

Dr. Tugwell: 12 million.

HM, Jr.: Henry Wallace tells me he has not yet been able to get a statement from Ickes on how much land will be put in production.

Dr. Tugwell: We arrived at a figure that was satisfactory to the President last year.

HM, Jr.: As I say, I know I am up against an almost impossible situation but I am going through and above board and make an effort. Nobody can say I am going behind his back.

Dr. Tugwell: I think this is the most fundamental relief that you can get.

HM, Jr.: If somebody some day would take these thousand pieces in this Relief program and make them headed and knew where we were going, it would be lovely.

Dr. Tugwell: I think it has worked out pretty well.

HM, Jr.: I am sorry - I disagree with you. You mean the whole relief thing?

Dr. Tugwell: Yes.

HM, Jr.: We have two million people on direct relief. The cost of direct relief is constantly mounting and you have at least one million people who want work and can't get work. It is all a part of relief.

Dr. Tugwell: It is not a part of the problem of administrative relief.

HM, Jr.: We are going round and round and round and there are more people on direct relief today than there were a year ago.

Dr. Tugwell: I think that we are the only people that have made any contribution to take people off relief.

HM, Jr.: My struggle is pretty big -- I expect too big -- but I would love to argue with you and Harry some evening.

Dr. Tugwell: I think we have 150 thousand families who would have been on relief who are not now.

HM, Jr.: Let me come back to the 24 - 48 hour basis; The other thing I would like to do just as soon as Harry has a night and you have a night.

Dr. Tugwell: Any one who has looked into the Rehabilitation thing says it is the only program that is really good.

HM, Jr.: You have \$48,000,000 to take this land out of production and the Forest Service has, how much?

Mr. Bell: 12 million. They had \$12,952,000 for their whole program. This is out of the 4 billion 8 and they had \$20,000,000 obligated and they have spent \$11,000,000.

HM, Jr.: How much altogether would they get?

Mr. Bell: Approximately \$25,000,000 for their whole thing and \$12,000,000 was for land. They say they have obligated \$20,000,000.

HM, Jr.: What was the rest spent for?

Mr. Bell: Administrative expenses, cleaning it up and so forth.

HM, Jr.: How much more for land?

Dr. Tugwell: That is all; except the Biological Survey got some but that was by statute.

HM, Jr.: \$60,000,000 for land out of production?

Dr. Tugwell: That is right.

HM, Jr.: How much to buy good land?

Mr. Baldwin: That is mixed up in our other funds; all mixed up in the projects. It will run from 12 to 15 million dollars.

Dr. Tugwell: I don't think its accurate to separate it from projects. You can't do a Resettlement job without land.

HM, Jr.: True, but how much would Ickes have to buy? Can you figure how much he is spending for land?

Mr. Bell: I don't think he is buying any land.

Dr. Tugwell: Of course he is.

Mr. Bell: You mean in Reclamation?

Dr. Tugwell: School houses have to have land. It all comes out of relief funds.

Mr. Bell: He loans 50% of the cost to the School houses and that is part of the land and part of the project.

Dr. Tugwell: Just the same as we do? He buys land the same as we do?

HM, Jr.: Let us say \$60,000,000 is spent to take land out. How much good farm land will Ickes bring in through building dams and all that sort of stuff.

Mr. Baldwin: That is going to be spread over a period of years.

Dr. Tugwell: I think we figure, over a period of two years, it would be 150 thousand acres. We have not been able to get figures.

HM, Jr.: But the figures on how many the various Reclamation projects will bring in?

Mr. Bell: Did not the Secretary of Agriculture say something at Emergency Council Meeting - and the President said he wanted it confined to 500,000 acres in the Reclamation Service.

Dr. Tugwell: What we arrived at was: He gave us \$100,000,000 for Reclamation projects and gave us \$20,000,000 for buying land and the other \$25,000,000 comes of the 3 billion 3.

HM, Jr.: Have you a regular form of contract that you use in buying this land?

Dr. Tugwell: Sure.

HM, Jr.: Could I see that?

Dr. Tugwell: Sure.

HM, Jr.: Maybe I could send somebody over to your shop?

Dr. Tugwell: He could see Dr. Gray or Monroe Oppenheimer.

HM, Jr.: And the other thing, you have over 500 thousand families that you have taken care of.

Dr. Tugwell: Over 600,000.

HM, Jr.: What is going to happen to these families after July 1st?

Dr. Tugwell: I have no more idea than you.

HM, Jr.: Dan, this is right well prepared. Under Rehabilitation loans to clients we run out of money in December.

Mr. Baldwin: Yes, all our money will be obligated on the first of July but a list of those payments are scheduled to go out.

Dr. Tugwell: We make a farm plan which is spaced over a year for farmers' meetings, which is supposed to rehabilitate them.

HM, Jr.: Then this money comes back? To what approximation?

Mr. Baldwin: About 70%.

HM, Jr.: And you have how much for Rehabilitation?

Mr. Baldwin: About 100 million.

HM, Jr.: Would you expect 70% of that to come back?

Mr. Baldwin: Yes, it comes of the miscellaneous receipts.

HM, Jr.: So we can't spend it again?

Mr. Bell: No, we can't spend it again.

HM.Jr.: Then out of the 275 million?

Dr. Tugwell: On our Resettlement project you will get 100% back. We sell the farms.

Mr. Bell: That is 22 million and you will not get any of the land retirement money back?

Dr. Tugwell: I had figured it. I could give it to you roughly. About another 70 million.

Mr. Bell: That would be 140 million, all told?

Dr. Tugwell: Yes, 140 million. You are going to get interest on all that comes back.

HM.Jr.: Is that fairly conservative?

Dr. Tugwell: Fairly conservative.

HM.Jr.: All long-term?

Dr. Tugwell: Some over 40 years.

HM.Jr.: Could you give me a memorandum on estimated repayments by kinds of projects?

Dr. Tugwell: Glad to.

HM.Jr.: Certain types of work where certain money is allotted and you expect so much back over a period of years? How much each year and do it by kinds of work?

Dr. Tugwell: All right.

HM.Jr.: I did not know it would be that much.

Dr. Tugwell: Our past experience leads us to believe we will get back 78%. We will get more in some States and in Georgia we have collected 80% already.

HM.Jr.: Myers averages about 70%.

Dr. Tugwell: Our loans are made very carefully.

Mr. Bell: Myers figures about 66 to 70% over a term of years. Last year it was only up to 56% but this year he will collect some.

Dr. Tugwell: Rehabilitation loans are two and five year loans -- Five years for capital goods and two years non-capital.

HM, Jr.: Are you still taking on new families?

Dr. Tugwell: Yes.

HM, Jr.: Have you set yourself a limit?

Mr. Baldwin: About 625 thousand families.

HM, Jr.: Is that the maximum you have set?

Dr. Tugwell: The maximum for our funds but you add that to our grants then we will be up to around 700 thousand families.

Mr. Baldwin: The total families we are looking after will be in excess of 700 thousand.

HM, Jr.: You buy this and that and the other thing and then you give them some land?

Dr. Tugwell: Not ordinarily.

HM, Jr.: Do you have different types of plans in different parts of the country?

Dr. Tugwell: Yes, but they are all on one farm. The County Committee figures what this man needs to be rehabilitated.

HM, Jr.: Have you written it down? Has it ever been explained?

Dr. Tugwell: No, I don't think so. Perhaps we ought to.

HM, Jr.: Do you have someone who could do that? Just take one page and show that this is the family we have in North Dakota and this is what we do for a North Dakota family.

Dr. Tugwell: It would not run by States but by individual families. They look at this fellow and say he is a one-horse farmer or a two-mule farmer.

HM, Jr.: Write down for any typical family in the Northwest and one typical family in the Southwest and show this is what we can do for them.

Dr. Tugwell: Sure. Be glad to.

HM, Jr.: Last year I took one week and every morning Hopkins brought over another man. We took two hours every morning. For one solid week we took two hours a day for him to explain the kind of work in each division.

Dr. Tugwell: How is your week now?

HM, Jr.: Not such a good week.

Dr. Tugwell: I will be glad to do that. We will be very glad to do it. You ought to take about five different people.

HM, Jr.: I can't do it now all five successive days. But if I gave 24 hours notice could you get the first fellow ready?

Dr. Tugwell: Be very glad to any time you say.

HM, Jr.: Then I would wait a couple of days and do another fellow.

Dr. Tugwell: I would like to get an understanding of the land program and Rehabilitation. The Rehabilitation is much the biggest.

HM, Jr.: I would love to do that too and maybe this \$48,000,000 - I would like to have that explained first. Because here is this thing. I can't put my head in the sand and say this is perfectly lovely when you have 500 or 600 families. No provision has been made for them. I have not been in Washington for three years not to know what is going to happen. Can a person say, you don't have to worry about these families because they are already taken care of because he will get by?

Dr. Tugwell: I know you can't.

HM, Jr.: Do you know what I recommended for the President. This in confidence. I recommended one billion 960 million dollars for relief for the fiscal year beginning July 1st and 100 million for Resettlement. That was my recommendation.

Dr. Tugwell: We are in such shape now that 100 million dollars would not do it because it costs so much to put our lands on the Resettlement. Construction projects. We are over 20 million dollars short.

HM, Jr.: You mean you have contracted for that much more than you got?

Dr. Tugwell: Yes. We had money when we started.

HM, Jr.: How many of those projects are there?

Dr. Tugwell: About 70 active ones.

HM, Jr.: That is your satellite cities?

Dr. Tugwell: No. We only have three of those going on - Milwaukee, Cincinnati and Beltsville. Bound Brook is an active one.

HM, Jr.: I thought it was agreed you would start one at Buffalo? You killed Chicago.

Dr. Tugwell: That was never active.

HM, Jr.: You mean you have actually signed contracts for people for construction work as we do in Procurement?

Dr. Tugwell: No. They are not contract jobs. The only problem will be that there are houses standing out in the field that have not been done.

Mr. Bell: But your suburban stuff is in pretty good shape now?

Dr. Tugwell: Except for out here in Berwin.

Mr. Bell: The only thing you have not been able to do is extend it, but you have brought your limit of costs down to funds available.

Mr. Baldwin: It was necessary to make that transfer to Berwin. We increased the limit on Berwin.

Mr. Bell: Was it not 26 million we said over last week?

Mr. Baldwin: Yes.

Mr. Bell: That brings them all within the fund?

Mr. Baldwin: Yes.

Dr. Tugwell: You got your original 58 million approved by the President, Dan?

Mr. Baldwin: We still have 58 million not approved projects but we don't have the money to start.

Dr. Tugwell: I have a date with the President. I must go.

HM, Jr.: I have about covered the thing. Dan, do you want to send someone over or should I have Oliphant send one of his lawyers?

Mr. Bell: If you are going to send someone on land contracts I think you ought to send somebody You had better send someone who understands politics.

Mr. Bell: Somebody handling land purchases for Procurement.

HM, Jr.: Law is his name. And the first morning I know I am going to have some time, let us get together again.

RESETTLEMENT ADMINISTRATION
DIVISION OF FINANCE AND CONTROL
ACCOUNTS AND SUBJECT CONTROL SECTION

STATEMENT SHOWING THE ACTUAL EXPENDITURES OF THE RESETTLEMENT ADMINISTRATION AS OF MARCH 31, 1966 AND THE ESTIMATED EXPENDITURES BY MONTH TO JUNE 30, 1967 OF BALUS OF FUNDS ALLOCATED AS OF APRIL 30, 1966

DESCRIPTION	APPROPRIATION SYMBOL	AMOUNT OF FUNDS	TOTAL EXPENDITURES BY MONTH	UNEXPENDED BALANCE BY MONTH	ESTIMATED EXPENDITURES													
					APRIL 1966	MAY 1966	JUNE 1966	JULY 1966	AUGUST 1966	SEPTEMBER 1966	OCTOBER 1966	NOVEMBER 1966	DECEMBER 1966	JANUARY 1967	FEBRUARY 1967	MARCH 1967	APRIL 1967	MAY 1967
ADMINISTRATIVE EXPENSE	090010	75,990,000.00	117,129,796.27	17,420,243.73	3,205,000.00	3,205,000.00	2,984,049.75	1,923,036.06	961,516.28	641,043.19	330,506.00							
MILITARY FARM RENT ADJUSTMENT	090010	2,000,000.00	307,024.98	1,792,975.02	162,064.94	259,840.00	300,665.25	338,595.00	321,727.31	342,291.64								
FARMER SUBSISTENCE ADVANCEMENTS	090990	2,470,500.00	2,028,714.91	324,790.38	324,790.38	324,790.38	324,790.38	324,790.38	324,790.38	324,790.38								
MINORIAL LAND PURCHASE PROJECTS	091707	30,730,541.00	7,786,005.48	15,944,540.50	1,941,711.03	2,330,054.20	2,309,645.11	2,230,056.73	1,913,711.64	1,294,471.00	647,297.67							
MINORIAL LAND PURCHASE PROJECTS	091707	3,300,000.00	1,292,706.22	2,007,293.78	314,076.65	377,151.29	410,150.71	230,980.48	324,479.65	300,951.10	104,290.36							
MINORIAL LAND PURCHASE PROJECTS	091906	30,000,000.00	78,783.75	19,731,217.25	796,194.49	696,900.68	1,184,870.23	1,394,460.31	1,309,667.36	1,792,623.93	1,907,274.79	2,111,323.90	2,110,340.07	1,692,121.79	1,393,677.26	156,000.16	697,694.58	736,421.34
FARMER SUBSISTENCE ADVANCEMENTS	090032	7,000,000.00	2,418,816.67	4,484,383.38	269,093.02	446,431.35	632,677.53	695,176.72	652,230.88	672,851.78	940,458.24	224,210.11						
RESETTLEMENT PROJECTS-LAND PURCHASE	090082	2,500,000.00		2,500,000.00			30,700.00	400,000.00	500,000.00	600,000.00	540,000.00							
MINORAL RESETTLEMENT PROJECTS	090032	31,000,000.00	3,135,687.47	27,864,312.53	1,476,647.02	1,949,903.24	2,227,520.54	2,505,971.66	1,794,415.20	2,794,415.00	1,794,415.00	2,794,415.00	2,794,415.00	2,794,415.00	2,794,415.00	2,794,415.00	2,794,415.00	2,794,415.00
MINOR RESETTLEMENT PROJECTS	090032	32,500,000.00	501,360.18	31,998,639.82	627,252.49	1,095,480.49	1,792,672.79	1,971,736.68	2,100,640.00	2,659,000.18	2,640,000.00	2,640,000.00	2,640,000.00	2,640,000.00	2,640,000.00	2,640,000.00	2,640,000.00	2,640,000.00
REDEVELOPMENT LOANS TO CLIENTS	090032	41,017,000.00	33,307,795.54	28,430,210.46	12,768,594.71	11,372,084.18	2,943,081.09	1,431,510.70										
LOANS TO COOPERATIVES	090032	2,145,000.00	1,242,290.20	89,220.10	61,200.00	71,100.00	71,100.00	71,100.00										
DIRECT GRANTS	090032	2,107,500.00	145,120.62	2,062,379.38	303,627.94	407,695.29	484,904.26	600,310.41	40,697.07									
DIRECT GRANTS	090032	10,100,000.00	10,500,966.05	5,098,387.05	5,984,723.97	2,725,264.91												
REDEVELOPMENT LOANS TO CLIENTS	090032	4,000,000.00	990,145.09	4,044,354.91	910,239.22	1,010,313.52	1,474,449.64	998,230.62										
REDEVELOPMENT LOANS TO CLIENTS	090067	39,800,000.00		22,000,646.00		1,484,023.42	9,768,179.90	2,794,129.70	5,794,129.70	4,207,076.00	7,894,064.00	2,440,416.02	600,000.00					
LAND USE DEVELOPMENT PROJECTS	090079	10,000,000.00	3,601,462.71	14,398,537.29	1,727,624.47	5,599,714.71	7,311,668.78	6,670,597.46	2,477,751.94	1,430,267.75								
ROAD RECONSTRUCTION COMMITTEE	090085	5,000.00					500.00	500.00										
FARM TRUST FUND	090711	100,000.00		50,000.00		100,000.00	50,000.00	50,000.00	15,000.00	30,000.00								
WINDFALL TRUST FUND	090761	27,637.70		27,637.70			15,000.00											
TOTAL		175,540,944.33	165,795,676.02	119,179,816.83	227,794,605.76	270,210,666.00	336,102,650.00	323,715,087.70	317,417,795.33	317,417,795.33	317,417,795.33	317,417,795.33	317,417,795.33	317,417,795.33	317,417,795.33	317,417,795.33	317,417,795.33	317,417,795.33

May 5, 1938

Hopkins and Bell met with the Secretary today. The following conversation took place:

HM, Jr.: Supposing the Treasury said to you, We will take off all of the so-called red tape. Can you, out of the 4 billion \$ go through to July 1?

Hopkins: If the regulations are abolished and we get no further funds from the Treasury other than the \$30,000,000 which is now in the hopper -- that is the 20 and 10 -- then we need no money until June 1. If the new bill is passed by June 1 and the money was available, there would not need to be further scraping of the 4 billion \$. (See Exhibit "A" attached for this paragraph and for numbers 2, 3 and 4 following.)

(2) If the restrictions are left as they are and if the bill is signed and the money made available by June 1, we would require \$195,000,000 more money.

(3) If the bill is signed by June 15, PWA would require \$280,000,000 additional, representing an increase of one-half month's cost or \$85,000,000 over the \$195,000,000 estimated for June 1.

(4) If the bill is signed on July 1, PWA will require a total of \$365,000,000 estimated on the same basis as above.

Mr. Bell: What would you do with \$365,000,000?

Mr. Hopkins: That is all because of the restrictions. It is not because we would spend it.

(Attached are other statements left with Mr. Morgenthau by Mr. Hopkins.)

Mr. Hopkins: In my own opinion, there is not enough money available that Dan can get transferred from other agencies which will keep our stuff going until the new bill is passed.

HM, Jr.: You are going to have to nick this \$1,500,000,000 for about \$100,000,000 prior to July 1? After July 1, it will be easier for Dan to get hold of some of this money, but I think \$100,000,000 is going to be obligated prior to July 1. Let's say that these regulations are off, Dan, and Harry has allocated to him 1 billion \$, then what you say is that the

-3-

men will have done the work in June and it will be owing to them for work done in June and that they will not be paid until sometime in July?

Mr. Bell: Yes. The obligation is incurred in June, but not liquidated until July.

HM, Jr.: What I am trying to get out of this meeting is to find a way out. From the President's standpoint, it is a tremendous mistake to have to admit that part of the \$1,500,000,000 is spent prior to July 1. The fact that it is obligated does not "cut any ice." The work is done and we owe the money to the men.

According to your own figures, then, as stated on sheet No. 2 (Exhibit B), we are \$80,000,000 apart. In other words, if you had another \$80,000,000 turned over to you, you would not need any of the \$1,500,000,000.

Mr. Hopkins: Yes -- 80 million in addition to the 30 million.

HM, Jr.: What I would like to do, and I can only do it with your help, is to have one more session with the President to see if we cannot get another \$80,000,000 for you.

Mr. Hopkins: I think in Tugwell's shop there is 25 million that Dan has hung up on a peg. I think this could be transferred to me if there was a firm commitment that this work would be done later. Then take the 25 million out of the \$1,500,000,000 and give it to Tugwell.

Mr. Bell: This cannot be done. The way the thing stands now is that Tugwell will not get any of this \$1,500,000,000 and Hopkins will have to take over Tugwell's organization and complete the Resettlement Program. I think the President could transfer Tugwell's money to Hopkins now, which he can use to take him through to July 1. Then when Hopkins gets the \$1,500,000,000 on July 1, he can reimburse "Resettlement Program" what he borrowed to use for his own shop.

HM, Jr. told Mr. Hopkins to go into Bell's office and talk the thing through further and arrange for another meeting on Thursday at 11:30.

ESTIMATED AMOUNT OF FUNDS NEEDED BY WPA

Assuming That Present Financial Procedure is not Revised

Experience indicates that under present financial procedure balances must be kept in the states at least six weeks in advance of actual obligations. This is caused, of course, by the necessity for setting up encumbrances for each of the 60,000 projects in operation. On this basis the estimates are as follows:

If the Bill is signed June 1, WPA would require a total of \$195,000,000 additional, representing the \$110,000,000 additional funds needed through June plus one-half month's requirement of \$85,000,000. —

If the Bill is signed June 15, the WPA would require \$280,000,000 additional, representing an increase of one-half month's cost or \$85,000,000 over the \$195,000,000 estimated for June 1.

If the Bill is signed on July 1, the WPA will require a total of \$365,000,000, estimated on the same basis as above.

Exhibit B.

ESTIMATED AMOUNT OF FUNDS NEEDED BY WPA

Assuming that Present Financial Procedure is Revised

If the revised financial procedure is agreed to, the WPA will need the following sums in addition to the \$1,402,000,000 allocated as of April 20 (\$30,000,000 has been signed by the President and is now pending).

These estimates are minimums on the assumption that the funds could be obligated on a theoretically perfect basis in each State and in each District.

* If the new appropriation is signed June 1, present funds, including the \$30,000,000 pending, should be sufficient. Realistically, however, there should be at least \$10,000,000 available to meet acute situations that are inevitable in certain States no matter how carefully the money is allotted.

If the Bill is signed on June 15, the WPA will need an additional \$85,000,000, or \$55,000,000 in addition to the \$30,000,000 pending. A similar margin of safety of \$10,000,000 additional should be allowed at this point.

If the Bill is signed on July 1, the WPA will need \$110,000,000, or \$80,000,000 in addition to the \$30,000,000 now pending.

WORKS PROGRAM EMPLOYMENT

	<u>TOTAL</u>	<u>W.P.A.</u>	<u>C.C.C.</u>	<u>ALL OTHER</u>
		<u>Actual</u>		
Feb. 15	3,819,000	3,018,000	467,000	334,000
March 14	3,845,000	3,000,000	449,000	396,000
April 18	3,558,000	2,654,000	403,000	521,000
		<u>Estimated</u>		
May 15	3,445,000	2,450,000	395,000	600,000
June 15	3,400,000	2,550,000	390,000	660,000

NOTE: W.P.A. Obligations will not vary in exact relationship to employment because:

- 1) Payrolls must be met after an employee is separated up to the amount already earned by that employee.
- 2) Erratic fluctuations in material purchases, method of obligating payrolls, and other technical considerations.

May 5, 1936.

WPA FUNDS

April 20, 1936

Total allocated	\$1,402,000,000
Obligated	<u>1,107,000,000</u>
Unobligated	295,000,000
Estimated requirements April 20 - June 30	405,000,000
Additional funds required to June 30	\$110,000,000
Now pending	<u>30,000,000</u>
Additional funds*	80,000,000
Total allocated as of June 30	\$1,512,000,000

*This sum is estimated on an actual obligated basis and assumes that the proposed change in financial procedure will be effectuated in order to allow flexibility in the use of funds within each limitation of the Act within a State.

OBLIGATIONS AND EXPENDITURES FOR WPA PROGRAM

	<u>Obligations</u>		<u>Checks Issued</u>	
	<u>Monthly</u>	<u>Cumulative to end of Month</u>	<u>Monthly</u>	<u>Cumulative to end of Month</u>
<u>Actual</u>				
Sept. 30	61,410,000	61,410,000	22,935,000	22,935,000
October	74,784,000	136,194,000	35,695,000	58,630,000
November	117,400,000	253,594,000	61,068,000	119,698,000
December	189,206,000	442,800,000	136,955,000	256,653,000
January	178,381,000	621,181,000	167,920,000	424,573,000
February	182,677,000	803,858,000	164,324,000	588,897,000
March	188,495,000	992,353,000	191,529,000	780,426,000
(April -20 days	114,346,000	1,106,699,000	118,031,000	898,457,000)
<u>Estimated</u>				
April (30 days)	180,000,000 ¹⁷⁰	1,172,353,000	1,162,100	
May	172,000,000 ¹⁶⁵	1,344,353,000	1,320	
June	165,000,000 ¹⁶⁰	1,509,353,000 ✓	1,310	

May 5, 1936

Estimated Cost of WPA - May.

State projects	\$150,000,000
NYA	7,000,000
Federal - WPA	6,000,000
Administration	6,000,000
Land Utilization	
Resettlement Administration .	<u>3,500,000</u>
 Total	 \$172,000,000

STATUS OF FUNDS ALLOCATED TO SPECIFIED AGENCIES

April 20, 1936

	<u>Allocations</u>	<u>Obligations Incurred</u>	<u>Checks Issued</u>
Works Progress Administration	\$1,401,778,000	\$1,106,699,000	\$898,457,000
Resettlement Administration	230,398,000	137,773,000	88,791,000
Public Works Administration Non-Federal	346,105,000	318,331,000	59,071,000
Public Works Administration Housing	101,373,000	27,169,000	13,801,000
Puerto Rico Reconstruction Administration	33,377,000	6,566,000	3,272,000
Treasury Department	54,241,000	26,919,000	24,832,000
Reclamation Bureau	76,680,000	38,828,000	10,023,000

May 5, 1936

May 5, 1936

HM, Jr. told McReynolds today that if the State Department wants to make another move with the Canadians about the liquor situation, it is agreeable to him, but he wants a letter or a promise from Secretary Hull and nobody else that beginning with Monday we can go ahead, full steam. He wants the backing of the State Department on this bill to go ahead on Monday.

* * *

HM, Jr. told Bell that he saw the President at lunch yesterday and put the following proposition to him: that he would see Hopkins today (Tuesday) and tell him that if he spends \$75,000,000 in June or \$25,000,000 out of the \$1,500,000,000, everybody is going to say, "Not only will the \$1,500,000,000 not last, but they have nicked it already in June. It is all a fake. It will not even last six months." The President said, "What do you want? Are you willing that I drive a bargain with Harry that if he will not spend a nickel out of the \$1,500,000,000 this year, we will raise the barriers?" HM, Jr. said, "I think it would be a terrific mistake if he starts spending out of the \$1,500,000,000 this year," and the President said "O.K."

HM, Jr. then said to the President, "I have sent a lawyer over to Tugwell to check up and see if all of the \$48,000,000 which he has to spend on the purchase of land has been obligated and if not, they should cancel the unobligated balance." The President approved.

Tuesday
May 5, 1936

HMjr: Hello -
H. M.
Cochran: Hello -
HMjr: Cochran?
C: Yes, Mr. Morgenthau -
HMjr: Good morning
C: Good morning, sir
HMjr: How are you?
C: Quite all right
HMjr: What's new?
C: The morning started out rather quietly -
HMjr: Yes
C: - up until noon the Guaranty had sold only three million dollars -
HMjr: Yes
C: - as compared with six yesterday noon.
HMjr: Yes
C: But I just talked with the Guaranty now and with Cariguel -
HMjr: Yes
C: They both report much greater activity since twelve o'clock.
HMjr: Now, what does that mean?
C: Up until this hour - it's now three o'clock here - it has done nine million alone.
HMjr: Who has?
C: The Guaranty
HMjr: Has done nine million?
C: Yes - Yesterday all day they did thirteen.
HMjr: What's that?

C: I say, during the whole day yesterday the Guaranty did thirteen million -

HMjr: Well, does that mean that from now on - I mean today it's gotten worse?

C: Since noon it has gotten worse than this morning and is going at about yesterday's rate now.

HMjr: At about yesterday's pace?

C: Yesterday's speed -

HMjr: Yes - yes

C: Because having been nine now they'll probably reach thirteen by evening.

HMjr: Yes - hello -

C: National City is the only other one in.

HMjr: Yes

C: In the market. The British control is intervening actively -

HMjr: Yes

C: And having a big day at seventy-five and seven sixteenths.

HMjr: Yes

C: The same rate at which they yesterday.

HMjr: Well, it's - we figured it out - yes, yes - now -

C: Seventy-five and seven sixteenths -

HMjr: Now, let me ask you something, have you seen Criguel today?

C: I talked with him on the phone just a while ago -

HMjr: Yes

C: But I am going to see him at half past five this evening.

HMjr: You are going to see him when?

C: At half past five.

HMjr: Yes

C: I saw him yesterday morning, - you know? Have you got that message ?

HMjr: Now - hello?

C: It's a summary of today.

HMjr: Yes - hello?

C: Hello - It's a Cochran message in which is summarized the day's developments.

HMjr: Yes - they - Lochhead got that late last night.

C: Well, I'll - I'll send this other one right fast for Tuesday.

HMjr: You will?

C: Yes - I'll see him at five-thirty.

HMjr: Yes

C: Yes - I'll see him at five-thirty.

HMjr: Yes

C: And the Cabinet meeting is going to be at four-thirty this afternoon.

HMjr: Four-thirty?

C: I talked with Baumgartner -

HMjr: Yes

C: - of the Ministry of Finance at noon.

HMjr: Yes

C: And at that time he did not think any important decision could be taken this afternoon.

HMjr: He doesn't think so?

C: No, but of course this financial situation has gotten worse since the three hours ago.

HMjr: Yes

C: But whether its had enough to cause them to take any decision yet I doubt.

HMjr: Well now -

C: The Ministry, you know -

HMjr: Hello?

C: Hello -

HMjr: Let me ask you -

C: must not put any restrictions on

HMjr: Now, wait a minute, I want to ask you a question.

C: Yes

HMjr: Do you think that the present cabinet will continue until June one?

C: It depends entirely on this monetary development.

HMjr: What's that?

C: It depends entirely on this franc situation.

HMjr: I see.

C: If this run continues as it has yesterday -

HMjr: Yes

C: and today I do not think this Cabinet can last.

HMjr: This what?

C: I do not think this Government can stay in until June.

HMjr: I see.

C: If this pressure lets up the next day or two I think they will continue it.

HMjr: Yes - well -

C: But I do not think this Government ought to take any restrictive measures -

HMjr: Yes

C: If restrictive measures seemed imperative they would probably step out and leave it to the Socialists.

HMjr: They would?

C: Yes, now that's the way it looks today.

HMjr: Well, in other words if this gold continues -
C: Yes
HMjr: -- the chances are that the Cabinet will be forced out?
C: That's it, yes.
HMjr: I get you.
C: Yes
HMjr: Well now, don't hesitate, if anything happens from the Cabinet or anything from Cariguel - use the telephone.
C: I didn't get your last sentence.
HMjr: If anything important happens use the telephone.
C: Surely.
HMjr: Yes
C: But I'll see my friend at five-thirty -
HMjr: Yes
C: a Cabinet meeting a little later.
HMjr: Well, you'll see him in what - about three hours?
C: Yes
HMjr: O. K.
C: And if there's anything urgent I'll telephone - if not I'll send a rush message.
HMjr: Yes
C: Summarizing it.
HMjr: All right
C: Goodbye
HMjr: Thank you - goodbye.

FEDERAL RESERVE BANK
OF NEW YORK

69

CONFIDENTIAL CORRESPONDENCE

DATE May 5, 1936.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION

L. W. Knoks

WITH BANK OF FRANCE

I called Mr. Cariguel at 11:33 a. m. today. He stated that morning had been fairly quiet in Paris but that since noon the drain on them was heavy again. The British had up to then done 250,000,000 francs and in addition \$20,000,000 worth of gold had been engaged for shipment to New York and that was not the end yet. Belgium was also sending some gold from them but neither the Swiss nor the Dutch rate had reached gold point. Shipments to New York were moving smoothly and some of the gold was being diverted by aeroplane to London and Holland. There was no evidence of hoarding by the public in France; nevertheless, as the figures indicated, export of capital was going on on a large scale. I asked whether the gold was being paid for in hoarded notes or entirely by means of discounts. Cariguel thought that whilst some of the hoarded notes might be coming back for conversion into gold the bank's portfolio would undoubtedly show a heavy increase.

I made reference to rumors that Spain was shipping gold to Paris. Cariguel confirmed this; he added that the amount was only small, the shipment consisting of gold coin which the Spanish Central Bank was selling to the public in Paris in order to take advantage of the premium on the coins.

I spoke of the cabinet meeting which, according to reports received here from Paris, was now being held there and asked whether, in his opinion, the present government would stay in until the end of the month and if so, whether they would continue their present policy. Cariguel replied that he did not of course know how long the old government would last but expressed the opinion that as long as it was in office it

FEDERAL RESERVE BANK
OF NEW YORK

69-A

CORRESPONDENCE

DATE May 5, 1938.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATIONL. W. KnokeWITH BANK OF FRANCE

- 2 -

ould defend the franc as heretofore. If the pressure became too strong, they might turn the helm over to the next fellow. With regard to the "new people" he thought they would be quite tame and tolerant.

I asked Cariguel, if at all possible, to keep me posted as developments and he promised he would do his best.

WK:KMC

May 5, 1936

At Taylor's house, last night, Bewley told me that he did not wish to take advantage of seeing me at dinner, but he wanted me to know that he had cabled to England my query and had received no answer. He evidently was quite embarrassed that he had not received an answer. I assured him that I had gone Chinese in my philosophy and that a week or a year meant very little to me. I told him it seemed unfortunate that we could not be civilized and have a channel open to exchange information. He completely agreed with me. The whole conversation was, on the surface, in a very light vein, but underneath both of us were very serious.

He asked me whether he could have any information on the Chinese negotiations and I told him that he would have to be patient for a few more days as we could not give him any information until the negotiations were completed. I said to Bewley, "I can tell you this: our negotiations are not selfish and our motives are in the best interests of China." He also made a funny remark. He said, "What do you hear about Leith-Ross?" and I said, "Very little." He said, "Well, don't you know what he is doing?" and I said, "No; don't you?" He said, "They don't keep me informed at all."

If Bewley did not get the point of my conversation when he was at the office, namely: that I was trying to open a channel to exchange information, he certainly got it last night. He said, "What do you think is going to happen in France? Do you think they will devalue?" and I said, "I think their first move will be an embargo on gold and that will not be so good for England, will it?" And he said, "No," and I think I implied at that point that if this happens it would be useful to have a channel opened to exchange information. Taylor added that before Bewley left he said to him, "I certainly think it would be desirable to have a channel open."

* * * * *

HM, Jr. called the President at 9:20. This is their conversation:

"I just talked to Paris and the Cabinet meets at 4:30 Paris time. That is in about two hours. The situation,

to boil it down, is this: if the monetary situation continues as acute as it is now, they have got to do something because it is going so fast. Up to noon it did not go so rapidly and suddenly it took another spurt. Cochran feels if the pressure on the franc continues, then the Cabinet has to do something. This Cabinet does not want to do anything and, therefore, they will resign. If the pressure lets up, they will continue until June 1. Our guess is that they will not do the clean-cut thing (go to an immediate devaluation) but they will embargo."

He told the President that he was at Taylor's house last night for dinner and that Bewley was present. HM, Jr. related to the President their conversation as it is recorded on page one herewith.

HM, Jr. then told the President the following: "The thing that you and I have to make up our minds about is this: if this gold continues to come in, the American banks and the American steamers will be filled up and the Bank of France will most likely ask us for help, and the question is, Do we want to help them? They have not asked us yet."

The President then asked, "What would happen if we would not let this gold in? Where would it go?" HM, Jr. said the franc would go down and Sterling would go up. "That would not bother us much, but it would be very embarrassing for England and it might force them to come and see us. Our only worry is when Sterling begins to drop and as long as it goes up, why worry? My only feeling is that I want to see this thing cleaned up and I just feel that France has to do it sooner or later and if we give them another artificial stimulant to tide them over, it will not do them any good."

The President then said, "In 1935 I believe we brought in about 1 1/2 billion dollars' worth of gold. This year we will bring in another billion dollars' worth. Gradually we will drain the whole supply. Then where are we? It is a little bit like the banker in a small community who begins to foreclose on a house. He gets the property. Then another house is foreclosed, and another one, and he gradually gets half of the land in the community. What happens? He takes the land out of circulation. Finally he gets three-fourths of the land. Then there is no market, because the land is out of circulation. Instead of profiting by his

purchases, he is left holding all the land without any market and, therefore, it isn't worth anything? I feel that way about gold."

The President asked, "What are the mechanics? Just how do we do this?" HM, Jr. replied, "The various banks, like the Guaranty, the Chase and the Bank of Manhattan, let's say, take \$50,000,000. The banks have reached their limit when they purchase that amount because they can only take 25% of their capital and surplus. Then the Bank of France asks the United States Government, 'Will you not buy some gold and hold it in France until there is another boat?' And we say, 'We are on an international gold bullion standard and we can't take it any faster than the boats can bring it in. Of course, Mr. President, they have not asked us yet, but the above will be the procedure should this ever come about.'"

He also said to the President, "By the way, the Chinese again gave us a demonstration. They detached their money from Sterling and they attached it to the Dollar, and they have kept their word. They said they would operate between the two and today they did it. Their memorandum is in and we are going over it and any time you want them now for tea, you can ask them and be very friendly to them."

* * * * *

Those present at the 9:30 meeting were McReynolds, Upham, Miss Roche, Gibbons, Haas, Taylor, Oliphant and Bell.

The Secretary discussed the case of the two men who were killed working on a Post Office building at San Antonio. He asked McReynolds to investigate the condition of their families, one of whom was a married man. The Secretary wants a bill introduced for the relief of the men's families, due to the fact that because of Government "red tape" there is no compensation provided for accidents of this sort. The bill would be similar to that suggested by the Secretary and passed by Congress for the relief of Mrs. McClary, whose husband, a policeman of Alexandria, Va., was killed while assisting the Alcohol Tax Unit in capturing a mountaineer moonshiner.

HM, Jr. turned over to Mr. Oliphant the resolution intro-

duced by Senator King and referred to the Secretary, under the terms of which the President would be authorized to extend to the Government of America, including the Dominion of Canada, an invitation to attend a silver conference, and asked Oliphant to look into it, but added, "I really think we just ought to stall on this."

The Secretary had before him a letter from Secretary Roper inviting the Secretary to name a representative on a board of three which would conduct an investigation of charges, made by striking seamen, concerning laxity on the part of the Inspection Service of the Department of Commerce. He also had a letter from Senator Copeland asking that Admiral Hamlet be named to a board which has been authorized by Senate Resolution authorizing the Senate Committee on Commerce to make recommendations for necessary legislation covering the safety of life at sea. (Copies are attached.)

HM, Jr. turned these letters over to Mr. Gibbons and told him that, in connection with Roper's letter, he did not want the Treasury to be part and parcel of a whitewash board. He suggested the following to Mr. Gibbons: "You go over and see Roper yourself, and tell him in the nicest way you know how that if he wants a representative of the Treasury, O. K. but he must be prepared that we will not 'pull our punches' and we will say just what we think, and unless he is prepared to have us take that attitude, not to include a Treasury representative on the Board."

Gibbons reported to the Secretary that he had received a letter from a member of the Speakers' Bureau of Democratic Headquarters, and others in the Treasury had received a similar letter, including Jack Harlan and Herman Oliphant, asking them to make campaign speeches. He added that he felt the situation was becoming very serious. The Secretary said he wanted to meet with his "Political Committee" either Wednesday or Thursday evening of this week at his home and would make a definite appointment tomorrow.

In connection with the question raised by the Secretary at yesterday's group meeting, concerning possible loopholes in the pending tax bill and their "plugging", HM, Jr. received last night at his home the following memorandum from Oliphant:

"After the morning meeting on the tax bill, worked on Harrison's suggestion of two slight changes to enable him to have the bill reported favorably.
"With Upham and Kent, saw Beaman, Parker and other

legislative experts at and after lunch to make a recheck on possible loopholes. I might say that our own experts on this are Messrs. Turney, Kent and Lusk, and possible loopholes have occupied most of their time since March first.

"Turney and Kent confirmed my statement this morning that all major loopholes have been plugged, and there remain only those miscellaneous minor possibilities of avoidance, possibilities which we always have in the case of any general tax bill.

"My recanvass of possible escapes with Beaman, Parker and O'Brien was not completed because of a special matter I shall mention below; although on general inquiry they referred only to Section 27(1) relating to intercorporate dividends which will have to be reworked because of the last minute amendment in the House making the dividend year the same as the taxable year.

"Instead of Harrison's suggestion of a flat exemption of \$3,000 for corporations with net incomes of less than \$30,000, Parker suggested that we adopt one table (that with the higher rates), let corporations figure their tax under it, and then tax corporations with incomes of less than \$15,000 or \$20,000 that fraction of the tax so calculated which their income is of \$15,000 or \$20,000. Much time was spent discussing this possibility of meeting Harrison's request for simplification, and it looks promising. George and I worked on it some this afternoon, and it looks as if it might be adopted without any loss of revenue.

"I might add generally that having gone through this whole process in the preparation of the Revenue Act of 1934, and the Revenue Act of 1935, and knowing how our own staff and the two staffs on the Hill work, things are moving and are being handled in the usual way, and, as usual, the process of perfecting the bill will continue until final enactment.

"Dr. Feis called me about a cablegram from Flack relative to the transfer of Brenner in Waite's office in Paris to Boston. I relayed the message to Gibbons as Feis requested."

HM, Jr's comments to Oliphant were as follows: "You assumed the responsibility of the tax bill and I am willing to rely on your judgment that you have it in hand. I place my reputation in your hands. You have not abused it yet. However, as people call various things to my attention, I will bring them to you. We are gambling to the extent of \$1,250,000,000 in revenue and you fellows must be triply sure that you are right. I leave it entirely to you and Haas."

Governor Myers sent a letter to the Secretary (copy attached) in which he asked that if the building at 406 13th Street should become available, it be turned over to Farm Credit for garage and storage space. HM, Jr. turned the letter over to McReynolds to investigate and McReynolds reported today that it is one of the buildings of which the Treasury is custodian and that at present this building is leased to A. W. Mellon. He felt it would be an opportunity for Republicans to hint of "persecution" and would be 100% wrong to take it away from Mellon. HM, Jr. said that absolutely the Treasury was not to take the property away from Mr. Mellon, who leases it for garage space.

Bell mentioned the controversy between Crowley of FDIC and the Comptroller's office over bills in Congress sponsored by Mr. O'Connor. Bell said that Crowley had called S. 4513 to his attention as being inimical to the interests of FDIC and asked Bell if it had been cleared through the Budget and Bell said it had not been. The Secretary asked for a memorandum on S. 4513, which Bell said he would submit. (Memo is attached hereto.)

74TH CONGRESS
2d Session

S. J. RES. 254

IN THE SENATE OF THE UNITED STATES

APRIL 24 (calendar day, APRIL 27), 1936

Mr. KING introduced the following joint resolution; which was read twice and referred to the Committee on Foreign Relations

JOINT RESOLUTION

Authorizing the President to extend to the governments of America, including the Dominion of Canada, an invitation to attend a silver conference.

- 1 *Resolved by the Senate and House of Representatives*
- 2 *of the United States of America in Congress assembled,*
- 3 That the President is authorized to extend to the govern-
- 4 ments of America, including the Dominion of Canada, an
- 5 invitation to attend a conference for the purpose of consid-
- 6 ering and devising plans to increase the use of silver for
- 7 monetary and other purposes, to bring about stabilization
- 8 of the price of silver, and to formulate a uniform policy for
- 9 such governments with respect to silver.

1 SEC. 2. The sum of \$100,000, or so much thereof as
 2 may be necessary, is authorized to be appropriated for the
 3 expenses of such conference, including salaries in the District
 4 of Columbia or elsewhere, rent, printing and binding, print-
 5 ing of official meeting cards, travel and subsistence, or per
 6 diem in lieu of subsistence (notwithstanding the provisions
 7 of any other Act), stenographic and other services by con-
 8 tract if deemed necessary, and such other expenses as may
 9 be deemed necessary by the Secretary of State by reason
 10 or such conference.

JOINT RESOLUTION

Authorizing the President in excess to the Government of
 America including the President of the United States
 to attend a secret conference.

1 Passed by the Senate and House of Representatives
 2 of the United States of America in Congress assembled
 3 that the President is authorized to attend to the govern-
 4 ment of America including the President of the United States
 5 in connection to attend a conference for the purpose of consid-
 6 ering and devising plans to improve the peace of the
 7 country and other purposes in being done stabilization
 8 of the peace of the world and to promote a common policy
 9 such Government with respect to other

2.1 REG 524

74TH CONGRESS }
2D SESSION }

S. J. RES. 254

JOINT RESOLUTION

Authorizing the President to extend to the governments of America, including the Dominion of Canada, an invitation to attend a silver conference.

By Mr. KING

APRIL 24 (calendar day, APRIL 27), 1936

Read twice and referred to the Committee on
Foreign Relations

May 5, 1936

At Taylor's house, last night, Bewley told me that he did not wish to take advantage of seeing me at dinner, but he wanted me to know that he had cabled to England my query and had received no answer. He evidently was quite embarrassed that he had not received an answer. I assured him that I had gone Chinese in my philosophy and that a week or a year meant very little to me. I told him it seemed unfortunate that we could not be civilized and have a channel open to exchange information. He completely agreed with me. The whole conversation was, on the surface, in a very light vein, but underneath both of us were very serious.

He asked me whether he could have any information on the Chinese negotiations and I told him that he would have to be patient for a few more days as we could not give him any information until the negotiations were completed. I said to Bewley, "I can tell you this: our negotiations are not selfish and our motives are in the best interests of China." He also made a funny remark. He said, "What do you hear about Leith-Ross?" and I said, "Very little." He said, "Well, don't you know what he is doing?" and I said, "No; don't you?" He said, "They don't keep me informed at all."

If Bewley did not get the point of my conversation when he was at the office, namely: that I was trying to open a channel to exchange information, he certainly got it last night. He said, "What do you think is going to happen in France? Do you think they will devalue?" and I said, "I think their first move will be an embargo on gold and that will not be so good for England, will it?" And he said, "No," and I think I implied at that point that if this happens it would be useful to have a channel opened to exchange information. Taylor added that before Bewley left he said to him, "I certainly think it would be desirable to have a channel open."

FEDERAL RESERVE BANK
OF NEW YORK

72

OFFICE CORRESPONDENCE

DATE May 5, 1936.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH
BANK OF ENGLAND.

TO: L. W. Knoke

Mr. Bolton called me at 2:39 p. m. and talked to me along the following lines:

"What we have in mind at the present moment is this:

There is a very heavy flow of gold from Paris to New York and Cariguel is having a very difficult time to keep the dollar rate down to 1519. We have an order from you to buy gold at \$34.77 an ounce. Would it interest you at all to divert some of the present flow from ^{Europe} Paris to New York and have us hold the gold here for your account? Our assumption is that you want to prevent some of the movement of gold from Paris to New York. At the present moment, with gold quoted here at above \$34.90, we cannot of course work at your limit of \$34.77 in London. Would you be interested in having us buy gold for you in Paris at \$34.77 plus cost of shipment from Paris to London, or at a total of about \$34.80? As I said before, Cariguel wants to keep the dollar rate in Paris down. At the clip at which the gold is moving out now it will soon be a question of finding accommodation on steamers. If a lack of shipping facilities should develop, the ^{Bolton} rate is likely to go up. If you are not in a position to pay more than \$34.77, it may of course be possible for us to work at that figure after the dollar in Paris has broken through 1519. If \$34.80 or thereabouts is too high for you to pay, maybe you can think of a counter proposal."

I told Bolton that we would of course discuss his suggestions with Washington but that I was a little doubtful because if we acted on his suggestion the gold would stand us more than \$35 per ounce if, subsequently, it had to be removed from London to New York. As long as the

DATE May 5, 1936.

OFFICE CORRESPONDENCE

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION WITH

L. E. Knoke

BANK OF ENGLAND.

- 2 -

price for delivery in London did not exceed our limit I did not think we cared particularly where they bought it. If it were bought in Paris and thus be prevented from coming over here, it seemed to me that was exactly what we were trying to accomplish. I promised, after further discussion here, to get in touch with him either by cable or by telephone. Bolton repeated that he had just wanted to put the idea into our mind, that if we could not pay more than \$34.77 we might perhaps be able to think of a counter proposal. At any rate, he hoped I would do my best.

I then inquired about the situation in France. Bolton thought the pressure on francs today was bigger than ever before. I mentioned that we had heard of gold engagements for shipment to New York totaling close to \$25,000,000 and that we understood the British Fund had purchased about 300,000,000 francs. Bolton replied that their purchases were a little bigger than that and that, in addition, Belgium had taken gold. He agreed with me that the Bank of France's total loss of gold today was probably in excess of 600,000,000 francs and repeated that, in his opinion, the latest attack upon the franc was the most serious one we had yet seen.

Bolton then mentioned that a story was going around in London to the effect that Sarraut was going to make a statement after New York's closing; naturally, nobody knew whether that was so nor what he was going to say.

LHK:EMC

728

LOCHHEAD'S REPORT TO THE SECRETARY

May 5, 1936

Walked home with the Secretary this evening in order to discuss two questions which came up this afternoon.

(1) The Bankers Trust Company, New York, received a cable from their London Office asking whether gold could be shipped from the United States to Great Britain by new regulations of the Secretary of the Treasury or whether further legislation would be necessary to allow such shipments. The Bankers Trust Company, New York, gave a copy of this cable to the Federal Reserve Bank of New York, who in turn notified us without advising the Bankers Trust Company that it had been brought to the Treasury's attention. Such shipments could of course be made by regulations issued by the Secretary without further legislation, but it was thought significant that this point should be brought up by the Bankers Trust Company at this particular time.

(2) The Bank of England called the Federal Reserve Bank of New York regarding the order placed with them to purchase gold in the London market at \$34.77 per ounce, and a memorandum covering this telephone conversation is attached hereto. Mr. Knoke was advised to inform the Bank of England that \$34.77 was the maximum price which could be applied to our order to buy gold in London as any price higher than \$34.77 would raise the cost of this gold when delivered to the United States to over \$35 an ounce. It was decided not to make any counter proposition such as suggested by the Bank of England. As American banks are apparently taking care of the gold movement from France to the United States in a satisfactory and normal manner, the implication by the Bank of England that the Bank of France required some help in maintaining the dollar franc rate does not seem warranted. Another

72C

-2-

May 5, 1936

reason for a refusal to raise our buying rate above \$34.77 for gold delivered in London but purchased in France is that this would mean that we would be paying a higher rate for gold in Paris than the commercial banks were doing at the present time.

Associated Gas
and
Electric

May 5, 1936

Wideman's memo to Secretary outlining present status of case and requesting interview to settle policy matters.

May 27, 1936

Conference in Secretary's office with Mr. Frederick S. Burroughs, a Vice President of Associated Gas, and Dr. Starch, in which Mr. Burroughs protested against Treasury's activities in connection with Section 77-b.

August 21, 1936

Oliphant's status report. Negotiations under way looking to possible agreement which would terminate Court proceedings.

September 29, 1936

Mr. Oliphant's memo on latest development in case. Proposed settlement being submitted to Judge Mack. Pro-

November 19, 1936

Wideman and Oliphant conferred with Secretary. Associated Gas is endeavoring to arrange some procedure for lifting the Government's lien so they can do some refinancing. He also informed the Secretary of proposal to appointment a commissioner who would attend directors' meetings. Wideman said Court might suggest him, to which Secretary gave no answer or comment.

November 20, 1936

HM, Jr's telephone call with Landis suggesting Kent discuss with him the proposal to appoint a commissioner.

January 6, 1937

Oliphant's full memo on draft of stipulation with Associated Gas and Electric.

February 10, 1937

Oliphant's memo reporting on hearings in the chambers of Judge Mack in which Wideman made it clear Government was not a party to approval of stipulations and reserved right to protect not only assets of the company but to collect its tax.

DEPARTMENT OF JUSTICE

May 5, 1936

The Honorable,
The Secretary of the Treasury.

My dear Mr. Secretary:

In conference with you several weeks ago you requested that I keep you in touch with developments in the Associated Gas and Electric Company case. I have talked to Mr. Oliphant about it from time to time. The attached memorandum will give you a general picture of the present status.

The 77B proceedings in New York have been very active. One phase went to the Circuit Court of Appeals. That Court entered an order on jurisdictional questions today. The taking of testimony on the question of insolvency will probably commence next week.

You will note from the enclosed memorandum that major questions of policy are involved as well as highly technical and complicated legal problems. Although there is no question of policy calling for an immediate decision, such questions will arise before long. I shall be glad to confer with you whenever you wish at such time and place as you may indicate.

Respectfully,

Frank J. Wideman

FRANK J. WIDEMAN,
Special Assistant to the Attorney
General.

May 5, 1936

The Honorable,
The Secretary of the Treasury.

My dear Mr. Secretary:

In conference with you several weeks ago you requested that I keep you in touch with developments in the Associated Gas and Electric Company case. I have talked to Mr. Oliphant about it from time to time. The attached memorandum will give you a general picture of the present status.

The 77B proceedings in New York have been very active. One phase went to the Circuit Court of Appeals. That Court entered an order on jurisdictional questions today. The taking of testimony on the question of insolvency will probably commence next week.

You will note from the enclosed memorandum that major questions of policy are involved as well as highly technical and complicated legal problems. Although there is no question of policy calling for an immediate decision, such questions will arise before long. I shall be glad to confer with you whenever you wish at such time and place as you may indicate.

Respectfully,

FRANK J. WIDEMAN

FRANK J. WIDEMAN,
Special Assistant to the Attorney
General.

RECEIVED
OFFICE

DEPARTMENT OF JUSTICE

May 5, 1936

In re: Associated Gas and Electric Company
(Taxes).

The Department of Justice entered the above matter on December 20, 1935, when Messrs. Oliphant, Jackson and Kent of the Treasury Department and Mr. Boyd of the Tax Division conferred with the Attorney General. That conference was in reference to action to be taken in the preservation of tax liens existing in favor of the Government and arising by reason of a jeopardy assessment in the approximate amount of \$50,000,000. At the time of the conference there was pending before Judge Mack in the Northern District of New York an involuntary petition filed by certain creditors seeking the reorganization of the Company under Section 77B of the Bankruptcy Act, as amended.

On Monday, December 23, 1935, the Government asked, and was granted, leave to appear in the 77B proceeding as amicus curia. Since that time we have carefully followed the proceedings in that case.

Upon the request of the Treasury Department we prepared and, on Monday, February 24, 1936, filed, in the Northern District of New York, a Bill in equity for the foreclosure of the tax lien. The Bill seeks (a) an injunction pendente lite to prevent the Company from disposing of its assets; (b) a receivership pendente lite to preserve the assets of the Company; (c) discovery as to the assets of the Company and their location; (d) a final decree enforcing the tax lien against the assets. The several defendants have filed general appearances and have filed motions to dismiss, and, in the alternative, to strike portions of the Bill.

A study has been made of the objections raised to the Bill and a memorandum of law embodying the results of that study has been prepared. The most serious question is whether a Bill to foreclose a tax lien on personal property falls within the general jurisdiction

-2-

of a court of equity. The contention will be made by the other side, no doubt, that the Government has a plain, adequate and complete remedy at law by summary process for distraint and sale. Our study convinces us, however, that the Bill is maintainable under the circumstances of this case. There may be minor objections to the Bill but these are easily curable by amendment. Of course, in the light of more complete investigation it may be deemed advisable to file an amended Bill.

There is now pending before the Congress a Bill to authorize the Federal District Courts to entertain suits for the foreclosure of tax liens on personal property. I have collaborated with the Treasury experts in the preparation of this Bill and Mr. Olyphant tells me that it has a good chance of passing at this session of Congress. It is deemed best to delay calling up for argument the Company's motions addressed to the Government's Bill of Complaint until Congress acts.

Assuming that the motions are denied, we will then be in a position to ask for an injunction pendente lite. The probabilities are that this will be granted. A somewhat similar injunction was granted by Judge Mack in the 77B proceeding last year. If we were successful in this, the Company would probably attack the validity of the assessment per se by answer. The anticipated ground of the attack is that the assessment is arbitrary and capricious; that the assessment was not arrived at through processes of reasoning which are requisite to the exercise of this discretion by the Commissioner. This, in my opinion, would present a justiciable question and the court would have the power to inquire into the truth of any such allegation.

Assuming that we would be able to overcome the hurdle last above referred to, we would then desire to seek the receivership aid prayed for in our Bill of Complaint. It seems doubtful that the court will grant this relief. The Company could urge upon the court many considerations against such drastic action. The Company could probably avoid the receivership by offering to deposit the securities subject to the lien with a designated depository to await the outcome of the suit. It seems logical to suppose that the court would be disposed to accept some such plan as an alternative to receivership. Once the validity of the lien is established the only judicial act necessary to dispose of the case would be to decree the sale of the property subject to the lien. The court might refuse to appoint receivers for this limited purpose. By this course

-3-

of reasoning I merely mean to suggest the difficulties in our path and not to suggest that no reasons exist for the granting of a receivership. In a sale of property of this magnitude, and in view of the fact that the Government is the complainant-lien holder, it would seem essential to have a receivership in aid of sale.

This brings us to the question as to what our attitude should be in reference to the 77B proceedings. If the bankruptcy petition is approved all other matters (except the proceedings before the Board of Tax Appeals) are automatically absorbed in the 77B proceeding. We could, of course, hold our equity suit in abeyance pending the outcome of those proceedings. If we pursued this course of inaction, our position would not be materially altered upon the approval of the petition. We would have no voice in the selection of trustees. We could (through the Secretary of the Treasury) reject any plan of reorganization which did not provide for the payment of the Government's taxes in full; but we would have no voice in the formation of a reorganization plan and, hence, would not be in a position to insist that some provision be made for the thousands of holders of Class A and common stock of the Company. If we should intervene as a petitioning creditor, it is extremely doubtful that the other creditors could question the Government's status as a creditor; if we do not intervene, and the petition is approved, any creditor and the trustees might attack the validity of the lien and the Government's creditor status when we seek to prove the tax claim. This might, conceivably, necessitate proving the tax claim before the court instead of the Board of Tax Appeals and of proving the validity of the jeopardy assessment.

The indications are that the court will soon reach a trial of the issue of insolvency. We are now conducting a lengthy study of the authorities on insolvency and methods of proving insolvency. We have furnished the Treasury Department with a statement of approved formulae. That Department is assimilating its data on the issue as applicable to the several formulae. Mr. Harrill, who handled the Mail Fraud Investigation for the Federal Bureau of Investigation will be employed by Treasury to apply the factual data contained in his report to the issue of insolvency. This work has been under way for about one month and it will be at least another month before we can reach a tentative answer to the question of insolvency. The work is being conducted with two objectives in view: (a) First to determine if the Company is solvent or insolvent; (b) in the second place, if the Company is determined to be insolvent, to prepare the evidence thereon for use in court, as though the Government were

going to prove insolvency without any aid whatsoever from any other litigant. In other words, if the Company appears to be insolvent from our study, we are going to have the Government ready to make out its own independent case.

If our study shows the Company to be insolvent and our ability to prove that fact, this raises a serious question of policy. Shall the Government take active steps to secure the approval of the petition in the 77B proceedings? This positive action, if thought desirable, may be taken in one of two ways: The Government can offer proof and actively participate (a) as amicus curia and in the nature of parens patriae; or, (b) as an intervening petitioning creditor.

The reasons in favor of active participation are three in number: (1) To protect the present tax claim of the Government. If the tax, as finally redetermined, should be between fifteen and thirty million dollars, it is difficult to understand how such an amount can be collected from an insolvent company without either disrupting the System, injuring the Service, or further mulching the investing public. A reorganization under Section 77B would seem to afford the only alternative. (2) To protect the Government as to future taxes. The System's tax matters are handled very largely by a personal company of Howard C. Hopson. It is to Mr. Hopson's personal advantage to have the tax affairs of the System in a confused state. If this System can be restored to a solvent basis under capable and honest management, the Government will stand to profit very materially through prompt collections of true tax liabilities. (3) To afford some measure of protection to security holders and the general investing public. In past years the Company has succeeded in placing in the hands of the investing public vast amounts of more or less worthless securities. Much of this has been due to financial racketeering on the part of the management.

It is a very serious question as to what stage of the trial of the issue of insolvency the Government should take positive action. Naturally we would like to see as much as possible of the proof of the petitioning creditors before deciding that question. However, if the Government is going to proceed independently in the bankruptcy proceedings such action should not be too long delayed.

Respectfully submitted.

Frank J. Wideman

FRANK J. WIDEMAN,
Special Assistant to the Attorney General.

May 5, 1936

The attached legal opinion from the General Counsel's office was prepared in answer to the Secretary's question, Could the Secretary of the Treasury resign from the Board of Trustees of the American Red Cross?

Since the Secretary has decided, for the time being, not to resign, this opinion is being filed for record purposes.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE May 1, 1936

TO Mr. Taylor
FROM Mr. Opper, Acting General Counsel

You have requested my opinion as to whether the Secretary may, if he so desires, resign from the Board of Trustees of the American National Red Cross.

The American National Red Cross was reincorporated by Act of January 5, 1905 (title 36, U.S.C., secs. 1-15). Section 5 of the Act provides for the governing body, namely, the central committee, consisting of eighteen persons, and section 9 provides as follows:

"The endowment fund of the American National Red Cross shall be kept and invested under the management and control of a board of nine trustees, who shall be elected from time to time by the incorporators and their successors under such regulations regarding terms and tenure of office, accountability, and expense as said incorporators and successors shall prescribe."

It seems clear that the provisions of section 9 do not express or imply a mandate from Congress that the Secretary of the Treasury must serve as a trustee of the Red Cross.

The regulations promulgated pursuant to section 9 appear in a pamphlet last printed in September, 1931 and containing the charter, by-laws, and endowment fund regulations. Section 1(a) of the regulations provides as follows:

"The Board of nine Trustees of the Endowment Fund required to be chosen by Section 8 of the Act to Incorporate The American National Red Cross, as

Handwritten notes:
7-20-36
81
100-2-10-36
2-2-36
Full
Red Cross

- 2 -

amended by an Act of Congress, approved June 23, 1910, ought always to include the three public officers of the United States who, by regular appointment and confirmation, are in discharge of public duties as follows:

- "1. The Secretary of the Treasury.
2. The Treasurer of the United States.
3. The officer of the United States Treasury Department who may from time to time be designated by the President of the United States as a member of the Red Cross Central Committee in pursuance of the last clause of Section 5 of the Act of Congress approved January 5, 1905.

"The President of the Red Cross be and he is hereby requested to notify the incumbents of the above-named offices of their designation by the Board of Incorporators of the American Red Cross to fill for the terms of their incumbency of the United States offices held by them respectively the three vacancies that will exist in the Board of Trustees on January 1, 1915, and after the said date to give similar notice as vacancies may occur among the United States officers referred to." (Underscoring supplied.)

By section 6 of the By-laws:

"The President of the United States shall, upon his acceptance, be ex-officio President of The American National Red Cross."

It would appear that the Secretary, the Treasurer, and the other Treasury Department official referred to are intended to be distinguished from the so-called "non-official members of the Board" which are provided for in section 1(b). That section provides, inter alia, that the terms of office of the six non-official members will be four years and that any vacancy that shall occur among them will be filled in a certain manner for the time to elapse before the next meeting of

the incorporators; and the three officials referred to above are listed, in the Report of the Board of Trustees for the fiscal year ended June 30, 1935, as "Ex Officio Members" (see page 161 of the Annual Report of The American National Red Cross for the year ended June 30, 1935).

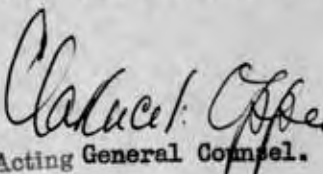
The regulations contain no provisions relating to the manner of filling vacancies occurring among the three "official" members of the Board for the obvious reason that the persons referred to (the Secretary, the Treasurer, and the Treasury Department official serving on the Central Committee) are at all times the incumbents of official government positions and are, presumably, constantly available to fill the three official memberships among the nine members of the Board.

I have no information as to whether any one who, by virtue of his holding public office, has heretofore been designated by the President as a member of the Board of Trustees has ever declined to serve or has resigned from the Board after accepting the designation. However, the provisions of the regulations appear to be merely advisory -- "The Board of nine trustees * * ought always to include the three public officers of the United States * * " -- and there would appear to be no more than a definitely expressed desire of the incorporators that these three officials serve as trustees and no more than a voluntary acceptance of the "designation" by the officials mentioned, to serve without compensation. In the absence of a statutory mandate, which is entirely lacking in this case, there would appear to be no method whereby any person

100-57

could be legally required to fulfill the duties of a trustee or could be legally prevented from voluntarily retiring from the Board at any time (Briggs v. Spaulding, 141 U.S. 132; In Re Guanacevi Tunnel Co., 201 Fed. 316; International Bank v. Faber, 86 Fed. 443; Fearing v. Glenn, 73 Fed. 116). In the usual instance, the duties of such an official are substantially similar to those of a director of a corporation and the performance of such duties is a purely voluntary matter with the individual in question, it being impossible as a practical matter to require a person, against his voluntary wishes, to exercise judgment and discretion in the fulfillment of duties and functions involved in the handling of an organization's funds or in its business problems.

Accordingly, it is my opinion that the Secretary may, if and when he so desires, resign from the Board of Trustees of the Red Cross.


Acting General Counsel.

April , 1936.

May 5th, 1936.

My dear Senators:

Thank you very much for your letter of May 1,
with which you transmitted copies of letters you had
written to Comptroller O'Connor and Jesse Jones
concerning Leo T. Crowley.

Sincerely,

(Signed) H. Morgenthau, Jr.

Secretary

Hon. Burton K. Wheeler,
United States Senate.

United States Senate

COMMITTEE ON INTERSTATE COMMERCE

BUNTON K. WHEELER, MONT., CHAIRMAN
 ELLISON D. SMITH, S. C.
 ROBERT F. WADSWORTH, N. Y.
 ALBEN W. BARKLEY, KY.
 M. M. NEELY, W. VA.
 WILLIAM H. DIETRICH, ILL.
 AUGUSTINE LONGWORTH, CONN.
 FRED H. BROWN, N. H.
 HOMER T. BONE, WASH.
 VIC DONAHUE, OHIO
 BISHOP MINTON, IND.
 A. HARRY MOORE, N. J.
 HARRY S. TRUMAN, MO.
 ELMER A. BENDON, MINN.

HENRIK SHIPSTEAD, MINN.
 MAUDE W. MITCHELL, CLERK

Washington, D. C. May 1, 1936.

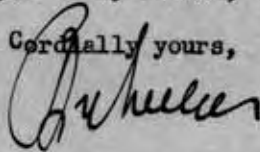
My dear Mr. Secretary:

For your information, I am enclosing herewith copies of two letters which I am this day sending to the Hon. J. F. T. O'Connor, Comptroller of the Currency, and Hon. Jesse Jones, Chairman of the R. F. C.

Assuring you of my esteem, I am

BKW:M

Cordially yours,



Honorable Henry Morgenthau, Jr.

Secretary of the Treasury

enclosures (2)

COPY

87

Washington, D. C. May 1, 1936.

My dear Jeffys:

In re: Leo T. Crowley

I was recently in St Paul speaking before a Democratic Convention, as you perhaps know, and heard several very ugly rumors with reference to the above named gentleman, to the effect that he was very heavily involved in some banks at Madison and Milwaukee, Wisconsin, and also some other banks which were taken over by these National Banks.

If the rumors which I heard with reference to his being involved to the extent of from 4 1/2 to 5 million dollars are true, it would account for some of the things which have been going on in the Northwest in permitting some of the banks to control his appointees.

I was informed that this was going to be brought out by the republican organization in the Northwest, and that this money had been made up to the banks by loans from the N F C.

If my informant gives me the correct information with reference to this, it seems as if it was a scandal which would equal the Teapot Dome.

I am taking the liberty of writing to you with reference to this matter, and to ask whether or not you have any information on this subject. I understand that you approved the appointment of Mr. Crowley in the first instance, and I can hardly believe that you would recommend a man for this position if the facts which have been given to me are correct.

I would kindly ask you to give me a report on the matter. If you feel you cannot do so without a resolution, I will introduce a resolution in the Senate calling upon you for any information you may have upon the subject.

With kindest personal regards, I am

Sincerely yours,

BK:WM

Hon. J. F. I. O'Connor,
Comptroller of the Currency
Treasury Department

COPY

88

Regraded Unclassified

Washington, D. C. May 1, 1936.

My dear Chairman:

When I was in St. Paul recently, a report came to me to the effect that Mr. Leo F. Crowley was involved in two banks in Wisconsin, one at Madison and the other at Milwaukee, and also in some other banks, which these two banks consolidated with.

It was also reported to me that the extent of his being involved in these banks was around five million dollars, that the loans made by the banks to him were upon extremely questionable paper, that in fact they were upon stocks which had not been authorized by the Company, or Secretary of State of Wisconsin.

I was also informed that because of these losses, the banks were forced to borrow from the F.F.C., and that your organization was thoroughly familiar with the situation, but that notwithstanding that fact you were one of those who recommended Mr. Crowley for his present position.

It is inconceivable to me, that if the facts as given to me are correct that you would have recommended him in the first instance. In view of the fact that statements were made to me that you were thoroughly familiar with these facts, I would ask you, whether or not, you have in your files any records, or any information, concerning the above matter.

If for any reason you feel you cannot furnish this information to me upon a mere request, I will introduce a resolution in the Senate, asking that the same be furnished to that body.

With kindest personal regards, I am

BRFWH

Sincerely yours,

Honorable Jesse Jones, Chairman

Reconstruction Finance Corporation

RECEIVED
MAY 17 1936
FEDERAL BUREAU OF INVESTIGATION
U. S. DEPARTMENT OF JUSTICE

Washington, D. C. May 1, 1936.

My dear Jefty:

In re: Leo T. Crowley

I was recently in St. Paul speaking before a Democratic Convention, as you perhaps know, and heard several very ugly rumors with reference to the above named gentleman, to the effect that he was very heavily involved in some banks at Madison and Milwaukee, Wisconsin, and also some other banks which were taken over by these National Banks.

If the rumors which I heard with reference to his being involved to the extent of from 4½ to 5 million dollars are true, it would account for some of the things which have been going on in the Northwest in permitting some of the banks to control his appointees.

I was informed that this was going to be brought out by the republican organization in the Northwest, and that this money had been made up to the banks by loans from the R F C.

If my informant gives me the correct information with reference to this, it seems as if it was a scandal which would equal the Teapot Dome.

I am taking the liberty of writing to you with reference to this matter, and to ask whether or not you have any information on this subject. I understand that you approved the appointment of Mr. Crowley in the first instance, and I can hardly believe that you would recommend a man for this position if the facts which have been given to me are correct.

I would kindly ask you to give me a report on the matter. If you feel you cannot do so without a resolution, I will introduce in the Senate calling upon you for any information you may have upon the subject.

With kindest personal regards, I am

Sincerely yours,

BKW*M

(Signed) Burton K. Wheeler

Hon. J. F. T. O'Connor,
Comptroller of the Currency
Treasury Department

COPY

Washington, D. C., May 1, 1936

My dear Chairman:

When I was in St. Paul recently, a report came to me to the effect that Mr. Leo T. Crowley was involved in two banks in Wisconsin, one at Madison and the other at Milwaukee, and also in some other banks, which these two banks consolidated with.

It was also reported to me that the extent of his being involved in these banks was around five million dollars, that the loans made by the banks to him were upon extremely questionable paper, that in fact they were upon stocks which had not been authorized by the Company, or Secretary of State of Wisconsin.

I was also informed that because of these losses, the banks were forced to borrow from the R.F.C., and that your organization was thoroughly familiar with the situation, but that notwithstanding that fact you were one of those who recommended Mr. Crowley for his present position.

It is inconceivable to me, that if the facts as given to me are correct that you would have recommended him in the first instance. In view of the fact that statements were made to me that you were thoroughly familiar with these facts, I would ask you, whether or not, you have in your files any records, or any information, concerning the above ~~aff~~ matter.

If for any reason you feel you cannot furnish this information to me upon a mere request, I will introduce a resolution in the Senate, asking that the same be furnished to that body.

With kindest personal regards, I am

Sincerely yours

(Sgd) Burton K. Wheeler.

Honorable Jesse Jones, Chairman

Reconstruction Finance Corporation



THE SECRETARY OF THE TREASURY
WASHINGTON

May 5th, 1936.

Dear Jefty:

On March 22nd, 1935, I wrote you the following note:

"Confirming my telephone conversation of today, I am waiting for your report on Mr. Crowley so that I can close out this matter.

"I think that the charges that you originated against Mr. Crowley should be substantiated or withdrawn."

I have not received an acknowledgment or further comment from you on this matter. In view of Senator Wheeler's letter to you of May 1, 1936, of which he sent me a copy, I think this matter should now be disposed of *without any further delay on your part.*

Sincerely,

Henry M. Munroe
Secretary

Hon. J. F. T. O'Connor,
Comptroller of the Currency



COMPTROLLER OF THE CURRENCY
WASHINGTON

May 5, 1936

My dear Mr. Secretary:

Thanks for your memorandum of May 5th in reference to Mr. Leo T. Crowley in your letter to me on March 22, 1935. You say that you have received no acknowledgment or further communication from me on this matter.

In this you are in error as I told you that I had received a full and complete report made by one of the Examiners of this office on the activities of Mr. Crowley in Wisconsin. I further advised you that I had also told Mr. Crowley that I had this complete report and Mr. Crowley told me that he hoped that I would not present this report to you as it would ruin him and that he desired to resign his office as Chairman of the Federal Deposit Insurance Corporation immediately upon the signing of the Banking Bill of 1935. I suggested to you that in as much as Mr. Crowley was going to resign I could see no need of opening this report and causing him any embarrassment. You felt that this was the proper position to take and since that time the matter has rested.

I attach herewith a memorandum handed to Under Secretary T. J. Coolidge under date of May 4, 1936, together with statements of loans in various banks by Mr. Crowley.

Very cordially yours,


J. F. T. O'CONNOR
Comptroller

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

May 4, 1936

MEMORANDUM:

With reference to the attached copy of letter and excerpts taken from reports of examinations of the First Wisconsin National Bank of Milwaukee dated April 6, 1934 and of the First National Bank of Madison, Wisconsin, dated April 27, 1934, it will be noted at the time of the examination the First Wisconsin National Bank of Milwaukee held obligations of Mr. Leo T. Crowley and his interests amounting to \$400,295.58. Similar obligations held by the First National Bank of Madison amounted to \$606,501.71.

The plans for recapitalizing the banks have been completed. Most of the loans referred to in the schedule held by the First Wisconsin National Bank were charged off. The bank still carries, according to the last report, the personal loan of Mr. Crowley in the amount of \$8,795 and charged off \$157,000 of the amount previously quoted. The only other loan carried by the above named bank is the balance of the indebtedness of the General Paper and Supply Company and the Crowley Wholesale Grocery Company amounting to \$57,781.

The bank referred to above reduced its common capital by \$5,000,000 for the purpose of assisting in the elimination of losses and increased its capital by selling \$10,000,000 preferred stock to the RFC.

The loans held by the First National Bank of Madison, amounting to \$606,501 have been entirely eliminated. These loans were acquired from the State Bank of Wisconsin at the time it was taken over and its liabilities assumed by the national bank, the national bank being guaranteed against loss by the Wisconsin Bankshares Corporation, which Corporation borrowed approximately \$4,500,000 from the RFC. On February 6, 1935 the Corporation transferred to the undivided profits of the subject bank \$996,847.91 in the final settlement of its guaranty in connection with the State Bank of Wisconsin assets. The items charged out were included and transferred to the Wisconsin Bankshares by way of an asset dividend to stockholders. The capital structure of the First National Bank of Madison was also strengthened by sale of \$500,000 preferred stock to the RFC.



TREASURY DEPARTMENT
COMPTROLLER OF THE CURRENCY
WASHINGTON

ADDRESS REPLY TO
"COMPTROLLER OF THE CURRENCY"

December 6, 1934.

My dear Mr. Secretary:

In response to your letter of yesterday advising me that the Secretary had called you on the telephone and is anxious to have in writing a memorandum outlining the facts in regard to Mr. Crowley, I am transmitting the following:

On or about February 5, 1934, Senator Vandenberg of Michigan called me on the telephone and said that he had information which led him to believe that he should vote against the confirmation of Mr. Leo T. Crowley as Chairman of the Federal Deposit Insurance Corporation. The Senator then sent a letter by messenger making specific requests for information, and in this letter, Senator Vandenberg said that he had had the confirmation of Mr. Crowley temporarily held up pending the receipt of certain information. On February 6, 1934, Senator Vandenberg sent a second letter requesting additional information. Copies of both letters from the Senator are attached to this memorandum.

I talked to Mr. Crowley about this matter and replied to Senator Vandenberg under date of February 7, 1934, copy of which is also attached. At the time I dictated the letter of February 7th, Mr. Crowley was at my desk and assisted me in compiling the information which I gave to the Senator. In order to secure up-to-date information, it was necessary to have an examiner make an investigation in Wisconsin, and at the suggestion of Mr. Crowley, I selected Mr. R.L. Hopkins who was a member of the national bank examining force, but at that time had been loaned to the Federal Deposit Insurance Corporation. Mr. Hopkins made a report to me, copy of which is attached. This report was transmitted to Senator Vandenberg and copy of my letter of transmittal is also attached hereto and copy of Senator Vandenberg's acknowledgement of the same.

A newspaper man recently advised me that Senator LaFollette was in the city a few days ago and had made the statement to a number of people that he would have a resolution introduced in the Senate investigating Mr. Crowley and the facts surrounding his appointment. My first information that Mr. Crowley was being considered for the Chairmanship of the Federal Deposit Insurance Corporation was from the press after the President had sent his name to the Senate. I felt it my duty, in view of the endorsement of the President and the Secretary of the Treasury, to do everything I could in an honorable way to have his appointment confirmed and Mr. Crowley appreciated very much what I did and the embarrassment that I saved him before the committee and also the final statement of Senator Vandenberg to me over the telephone that if I would so express myself, he would withdraw his objections to the nomination. You will note in Senator Vandenberg's letter of February 15, the following paragraph:

-E-

"On the basis of these communications, Mr. Crowley's nomination was confirmed last night. I hope he will fully justify the confidence which we all are reposing in him. I feel sure he will make every effort."

When my attention was called to Senator LaFollette's position, I made a further examination of my records as well as the last examination of the bank, which I had not done before this incident and it would appear that the Hopkins report is misleading in the following particulars:

His report shows Mr. Crowley owed the First Wisconsin National Bank of Milwaukee \$160,295.58, whereas the National Bank Examiner's report of April 6, 1934, shows that Mr. Crowley owes the bank \$274,295.58.

Mr. Hopkins' report states that on December 31, 1933, the net proprietary interest in the General Paper and Supply Company (largely owned by Mr. Crowley) is \$435,635, with current assets of \$491,259 and current liabilities of \$36,632; that included in the current assets, however, is an excessive amount of receivables which should be substantially discounted, but on the other hand, the company owns the entire stock of the Goodall Crowley Oil Company, which shows a net worth of \$148,060, with current assets of \$192,632 and current liabilities of \$5,962. This appears to be somewhat at variance with the National Bank Examiner's report which shows the General Paper Supply Company and the Goodall Crowley Oil Company owed the First Wisconsin National Bank \$124,500, the Examiner stating that of the receivables of the General Paper and Supply Company, \$334,000 was due largely from the Crowleys and that the receivables of the Goodall Crowley Oil Company, \$134,000, are practically all due from the Crowleys.

Mr. Hopkins' report states that Mr. Crowley and his brothers have full operating control of the corporations and he has been advised are making satisfactory progress in operating such corporations.

The Bank Examiner states Mr. Crowley is too badly extended to give any protection to his indebtedness as maker; that \$5,500 represents delinquent interest due; that his collateral consists of stock in a closed Madison bank and 438 shares of General Paper Supply Company and Crowleys' Wholesale Grocery Company, which is worthless. The Examiner states the indebtedness of Mr. Leo T. Crowley originally represented a reorganization of the Crowley debts on a four-year plan that was unsuccessful and that the obligations were rearranged in March, 1933, to be payable five years later, with interest at 2% per annum.

The Wisconsin Bancshares Corporation has secured a loan from the Reconstruction Finance Corporation in the amount of \$4,000,000, which it is understood is to assist in taking care of these losses.

-3-

Attached hereto are copies of schedules taken from reports of examination, one from the First National Bank of Madison, Wisconsin, report dated April 27, 1934 and one from the First Wisconsin National Bank, Milwaukee, Wisconsin, dated April 8, 1934. These were the last examinations of these banks made by the Comptroller's Office. However, in the regular course they will be examined again shortly.

Cordially yours,

J.F.T. O'CONNOR,
Comptroller.

Honorable T. J. Coolidge

Under Secretary of the Treasury.

LOANS AND DISCOUNTS:

	Slow	Doubtful	Loss
\$108,500.00			
Leo T. Crowley	\$40,000.00	\$8,000.00	\$60,500.00
A.W. Schulkamp			

Collateral is a contract dated June 28, 1952 of Young & Co. sold to Wm. H. Hatton by Crowley as Trustee. Original amount 90M has been paid down to 48M. It is claimed by Hatton contract has been paid down to 40M. The lumber, which originally was the basis of the contract, was moved into Hatton's own yards and the greater portion sold or absorbed in the inventory of Hatton & Co. so that it cannot be identified. No supporting data for Wm. H. Hatton signature, but claimed responsible for balance of contract.

\$1,500.00 Ind.	8,795.58	25,000.00	132,000.00
165,795.58			
Leo. T. Crowley			

Badly involved with heavy other bank obligations. Slow portion protected by share in substandard listed and unlisted stocks held for the benefit of this bank and the 1st Nat. Bank of Madison. No evidence of ability to pay. Obligation dated 1933 maturing 1938 @ 2% interest.

124,500.00	60,000.00		64,500.00
General Paper Sply.			
and Crowley Wholesale			
Grocery Company. Coll. stock			
Goodall-Crowley Co. has no val.			

This stock is held pro rata with claim of 156,000. held by State Bank of Wis. Quick assets of 166,700.00 against current debts of 50.7M. Debt to subject bank and obligation to State Bank of Madison in amount of 156,000. deferred to 1937. Included in assets are 105,600. entire stock of Goodall-Crowley which is believed worthless and 325,700. due from officers. Sales last year 408,000. with net profits of 2,000. Fixed assets carried at 130M with enc. of 10,000.

This bank has plans approved for reducing its common capital from \$10,000,000 to \$5,000,000, using the released capital and part of its surplus funds to charge off losses; and increase its capital by selling \$10,000,000 preferred stock to the R.F.C.

LOANS AND DISCOUNTS	Slow	Doubtful	Loss
350,476.38 Leo. T. Crowley Based on participation sundry stocks together with guaranty of unknown value at this time.	\$20,000.00	\$35,000.00	\$295,476.38
156,025.33 General Paper & Supply Co. Collateral of no credit value. Statement would suggest liquidation possible as shown.	89,000.00		67,025.33
100,000.00 Goodall-Crowley Oil Co. Statement poor. Payments should develop per schedule of maturity, Liquidation as classified a suggested possibility.	50,000.00	10,000.00	40,000.00

The Holding Company affiliate of this bank has a plan approved whereby it will borrow \$4,000,000 from the R.F.C. About \$1,000,000 of this amount is to be used to eliminate unsatisfactory assets in the bank. The bank itself is selling \$500,000 of preferred stock to the R.F.C.

May 5, 1936

I just called McIntyre about the O'Connor-Crowley fight and McIntyre said he was just calling me; that he was very much worried about it; that O'Connor had been over to see him and O'Connor seems worried. I read McIntyre my letter to O'Connor which I sent in to O'Connor this morning. It was news to McIntyre.

I told McIntyre that Vandenburg knows all about this. He said, "I know he does," and he said "Both O'Connor and Crowley have got to explain some of the things that they have done." He then asked me to come to, I gathered, a confidential meetings at 2:30 on Housing and wanted me to stay behind after the meeting and talk to the President about O'Connor and Crowley.

At 5 P.M. on May 5, 1936, the Secretary called Comptroller O'Connor and Mr. McReynolds in his office to discuss the record as to what had happened with respect to certain charges made against Chairman Leo T. Crowley, of the Federal Deposit Insurance Corporation. The Secretary called the Comptroller's attention to his (the Secretary's) letter of May 5, 1936, to the Comptroller, which recited the fact that the Secretary's letter on the same subject addressed to the Comptroller on March 22, 1935, had not been acknowledged or commented upon since its receipt by the Comptroller, and to the following statement in Mr. O'Connor's reply of May 5th as follows:

"In this you are in error as I told you that I had received a full and complete report made by one of the examiners of this office on the activities of Mr. Crowley in Wisconsin. I further advised you that I had also told Mr. Crowley that I had this complete report and Mr. Crowley told me that he hoped that I would not present this report to you as it would ruin him and that he desired to resign his office as Chairman of the Federal Deposit Insurance Corporation immediately upon the signing of the Banking Bill of 1935. I suggested to you that in as much as Mr. Crowley was going to resign I could see no need of opening this report and causing him any embarrassment. You felt that this was the proper position to take and since that time the matter has rested."

- 2 -

The Secretary explained to Mr. O'Connor that his records indicate that it is Mr. O'Connor who is in error. He exhibited to Mr. O'Connor his diary entry of March 12, 1935, which indicates very clearly that Mr. O'Connor's conversation with the Secretary referred to in his (O'Connor's) letter of today actually took place on March 12, 1935. The Secretary also called Mr. O'Connor's attention to the fact that on March 21, 1935, after staff meeting, the Comptroller remained to speak to the Secretary alone and at that time stated that he had received a voluminous report on the Crowley matter and had placed the report in the lower drawer of his desk unopened; that after reflecting on the matter he (the Secretary) came to the conclusion that he was unwilling to assume any share of the responsibility for delaying final disposition of the charges against Mr. Crowley and undertook to discuss the matter further with Comptroller O'Connor the next day March 22, 1935; that he discovered Mr. O'Connor was not in his office and finally located him by telephone in the Federal Reserve Board offices and undertook over the telephone to make clear to Mr. O'Connor that he, Secretary Morgenthau, considered that final disposition of the Crowley case rested on the receipt of a report from Comptroller O'Connor substantiating the charges and that the matter should be closed up promptly one way or the other; and that after concluding the telephone conversation, for fear Comptroller O'Connor did not clearly understand his attitude, he had written the Comptroller his letter of March 22, 1935, stating his position as follows:

- 3 -

"Confirming my telephone conversation of today, I am waiting for your report on Mr. Crowley so that I can close out this matter.

"I think that the charges that you originated against Mr. Crowley should be substantiated or withdrawn."

Mr. O'Connor stated that he had no documentary evidence to substantiate his recollection as to discussions with the Secretary on this subject subsequent to March 22, and that he would not further challenge the Secretary's recital of what had transpired, but that he relied upon the Secretary's conversation with him on the same day as justification for assuming that he, the Comptroller, was to do nothing further in the case until after the Secretary's return to Washington a week later. The record of this telephone conversation is attached. The last and significant part of it is as follows:

"H.M. Jr: - and you came to Coolidge and then Coolidge made these analyses -

O'C: That's Right.

H.M. Jr: -and then you said you weren't satisfied -

O'C: That's right.

H.M. Jr: -and you said you'd make additional investigations -

O'C: That's right.

H.M. Jr: Now -

O'C: It's all correct.

H.M. Jr: My position is I'm waiting for you to either clear the

man or to bring charges.

O'C: Well, if - if - if - if the thing - if the thing - if he should fade out, do you think it's necessary to injure anybody?

H.M. Jr: Well, I've just simply got to take the position that I'm waiting for a report from you.

O'C: Well, that's alright, then. If you'll do that until you get back I'll sit down and talk with you about it.

H.M.Jr: All right.

O'C: All right."

The Secretary pointed out the fact that his letter to the Comptroller dated March 22, 1935, was written subsequently to and in confirmation of his understanding of the telephone conversation in question, and that the letter must be accepted as a clear statement of his position, and that on that basis the responsibility for delaying disposition of the charges against Mr. Crowley rested solely with the Comptroller.

The Secretary stated that he felt the Comptroller had improperly and without justification misrepresented to Assistant Secretary Gibbons, Chairman Jesse Jones of the R F C, and Marvin McIntyre and conceivably to others that the withholding of final disposition of the Crowley case was due to the Secretary's disinclination to press the matter, and in that connection had called attention of at least one gentleman named to the fact that Mr. Crowley had employed the Secretary's nephew in his organization at liberal compensation. The Secretary stated that he felt Mr. O'Connor had undertaken to defend his own actions in this matter at Mr. Morgenthau's expense. The Comptroller vehemently disclaimed

any derogatory statements concerning the Secretary to anyone at any time and stated that he had and would continue to defend and praise the Secretary's official acts and conduct at all times and under all circumstances. The Secretary stated that he did not consider that Mr. O'Connor's actions in this case justified such a statement on his part. The Secretary told Mr. O'Connor that he was not looking for advice from anyone as to what action should be taken in this or any similar case; that what he had originally asked for and was still seeking was substantiation of the charges made against Mr. Crowley and if substantial proof were offered of improper actions indicating unfitness to hold the responsible position now occupied by Mr. Crowley, he would insist on Mr. Crowley vacating that position, but if on the other hand no such substantial evidence were forthcoming, he felt the matter should be disposed of and the cloud lifted from Mr. Crowley.

The Secretary stated that Chairman Jesse Jones had requested a hearing with the President on this matter and that the President had fixed 11 o'clock tomorrow, May 6th, to discuss the matter with Mr. Jones, Mr. McIntyre and Mr. Morgenthau, and had requested that Mr. O'Connor be present at that conference and produce the report concerning Mr. Crowley, which the Comptroller had stated he still holds unopened in his desk. Mr. O'Connor promised to be present at that conference.

. . .

March 22, 1935.

Dear Jefty:

Confirming my telephone conversation of to-day, I am waiting for your report on Mr. Crowley so that I can close out this matter.

I think that the charges that you originated against Mr. Crowley should be substantiated or withdrawn.

Sincerely,

Mr. J. F. T. O'Connor,
Comptroller of the Currency,
Washington, D. C.

March 22, 1935.
Friday.

106

H.M.Jr: Hello.

O'Connor: Hello.

H.M.Jr: Jefty?

O'C: Yes, sir.

H.M.Jr: Henry Morgenthau.

O'C: Oh yes, how are you?

H.M.Jr: Are you in the hotel?

O'C: No, I'm over here in the Federal Reserve Board.

H.M.Jr: Oh.

O'C: We're having - we started a meeting about 2:30 and we're still in it.

H.M.Jr: Oh. I wanted to talk to you about the Crowley matter.

O'C: Oh yes. Anything happened recently?

H.M.Jr: No, I've been talking it over. I - I've got Oliphant and Jefty here, Oliphant and Jeff Coolidge in my room and we've been going over things and I'm going away tomorrow night.

O'C: Yes. Going to be away long?

H.M.Jr: No, for a week.

O'C: Oh yes.

H.M.Jr: - and I - I simply feel that this whole matter is resting on receiving the report from you.

O'C: That's right.

H.M.Jr: - and I - I think we ought to close up the matter one way or the other.

O'C: Well - of course, the only danger of holding it is if somebody up there, like our friend from Louisiana or somebody should - if some busy fellows out there should get busy and get him to shoot off and make it embarrassing here. Now,

that's the only chance we're taking, but I'm - I'm sure - my best judgment is not to open this thing until you get back. That'd be my best judgment, then let's sit down with it, Henry.

H.M.Jr: Well, I haven't opened it. I feel that - you see you started -

O'C: I know, I know and I'll - I'll open it and go through, but I - I -

H.M.Jr: - and I feel that the responsibility is yours.

O'C: That's right.

H.M.Jr: - and - I mean it so happened that I was down at Sea Island Beach -

O'C: That's right.

H.M.Jr: - and you came to Coolidge and then Coolidge made these analyses -

O'C: That's right.

H.M.Jr: - and then you said you weren't satisfied -

O'C: That's right.

H.M.Jr: - and you said you'd make additional investigations -

O'C: That's right.

H.M.Jr: Now -

O'C: It's all correct.

H.M.Jr: My position is I'm waiting for you to either clear the man or to bring charges

O'C: Well, if - if - if - if the thing - if the thing - if he should fade out, do you think it's necessary to injure anybody?

H.M.Jr: Well, I've just simply got to take the position that I'm waiting for a report from you.

O'C: Well, that's all right, then. If you'll do that until you get back I'll sit down and talk to you about it.

H.M.Jr: All right.

O'C: All right.

revised letter

May 6th, 1936.

Dear Jeffy:

I have received your letter of May 5th, 1936, in response to mine of the same date concerning the disposition of certain charges made against Chairman Leo T. Crowley of the Federal Deposit Insurance Corporation more than a year ago, in which you state I am in error in my statement that I have received no acknowledgment of my letter of March 22nd, 1935, nor any comments from you on the matter since that date.

I call your attention to the fact that according to my diary, in which I preserve a daily record of my official acts, the conversation, to which you refer in your letter to me, took place on March 12, 1935; that you reported to me after staff meeting on March 21, 1935, that you had received a voluminous report on the Crowley matter and that you had placed it unopened in the bottom drawer of your desk; that I called you on the telephone the next day, March 22, 1935, and told you that I felt the Crowley charges should be disposed of promptly one way or another, and that I was waiting for a report from you substantiating the charges which you had undertaken to investigate further after a previous report on the matter had been analyzed by Jeff Coolidge; and that after I had concluded my conversation with you on the telephone, in order to make doubly sure that I had made myself entirely clear, I wrote you the letter of March 22, 1935, stating that I was waiting for your report on Mr. Crowley so that I could close the matter up, since I felt the charges should be substantiated or withdrawn.

In view of the clearness of my records of this matter, I am convinced that your recollection is at fault.

Sincerely,

Jgd - Wsh
Secretary

Hon. J. F. T. O'Connor,
Comptroller of the Currency.

may 6. 109

Dear Henry,

As I told you yesterday, there are rumors and statements that have come to the White House to the effect that certain individuals who had dealings in the Banking affairs of Mr. Crowley were later employed by Mr. Crowley, and I believe this should also be straightened out while the present investigation is on. If it should appear that any of the following individuals ever received any compensation from the Federal Deposit Insurance Corporation,

Tom Reese
Fred C. Kellogg
R. L. Hopkins
C. L. Pitman
Herman L. Eckern
Attorney Dempsey

the amounts of such compensation should be ascertained, as well as the date of appointment, if any have been appointed by the Corporation, also a statement as to whether or not any of these individuals were formerly employed by Mr. Crowley in Wisconsin in connection with any of his loans, banking activities, making reports or audits for him, or associated with him in any of his enterprises or banks - also if he dealt with any of them in any official capacity in Wisconsin.

Dear Henry,

As I told you yesterday, there are rumors and statements that have come to the White House to the effect that certain individuals who had dealings in the Banking affairs of Mr. Crowley were later employed by Mr. Crowley, and I believe this should also be straightened out while the present investigation is on. If it should appear that any of the following individuals ever received any compensation from the Federal Deposit Insurance Corporation,

Tom Reese
Fred C. Kellogg
R. L. Hopkins
C. L. Pitman
Herman L. Eckern
Attorney Dempsey

the amounts of such compensation should be ascertained, as well as the date of appointment, if any have been appointed by the Corporation, also a statement as to whether or not any of these individuals were formerly employed by Mr. Crowley in Wisconsin in connection with any of his loans, banking activities, making reports or audits for him, or associated with him in any of his enterprises or banks - also if he dealt with any of them in any official capacity in Wisconsin.

Dear Henry,

As I told you yesterday, there are rumors and statements that have come to the White House to the effect that certain individuals who had dealings in the Banking affairs of Mr. Crowley were later employed by Mr. Crowley, and I believe this should also be straightened out while the present investigation is on. If it should appear that any of the following individuals ever received any compensation from the Federal Deposit Insurance Corporation,

Tom Reese
Fred C. Kellogg
R. L. Hopkins
C. L. Pitman
Herman L. Ekern
Attorney Dempsey

the amounts of such compensation should be ascertained, as well as the date of appointment, if any have been appointed by the Corporation, also a statement as to whether or not any of these individuals were formerly employed by Mr. Crowley in Wisconsin in connection with any of his loans, banking activities, making reports or audits for him, or associated with him in any of his enterprises or banks - also if he dealt with any of them in any official capacity in Wisconsin.

TREASURY DEPARTMENT

112

INTER OFFICE COMMUNICATION

DATE May 6, 1936.

TO Secretary Morgenthau

FROM Mr. Taylor

Subject: Points in the memoranda submitted by the Chinese representatives to which the Secretary's attention is particularly called.

I

"Memorandum on increasing the use of silver"

1. In the second paragraph of Section IV, Page 4, with reference to the minting of the new silver coins in China, there is no indication of the length of time that will be required to prepare the Central Mint for the task of minting sizeable amounts of the new silver coins.

The history of the operation of the Central Mint is one which may justly raise some doubts whether the necessary alterations will be completed quickly.

It would create a favorable impression here, and would at the same time avoid uncertainty as to the time of issue of the new silver coins if the Chinese Government were to have the new coins minted here until such time as their own mint was ready to take over the operations. There would be a double advantage to the Chinese Government in that arrangement: (1) they would expedite the appearance of the new coins and increase their excess reserves; (2) there would be a small saving - if a credit is to be extended requiring silver as collateral - because the silver received in form of old yuans would have to be refined here at their expense. If the old coins were to be minted into new ones, the expense of conversion would be less, and if the silver sent here as collateral was eventually to be withdrawn, the difference in cost of refining old yuans into bars and into coins would be saved.

2. Of the 200 mill. yuan coins mentioned on Page 4 as the amount the Chinese Government hopes to issue, it is to be noted that 130,000 of such coins are to replace an equivalent amount of yuan paper notes now outstanding (as mentioned on Page 5).

- (a) Insofar as new coins were issued in place of paper notes, the cash reserve back of the notes would be freed, and could serve as a basis for new note issues. For every 100 yuans of notes replaced by silver coins, enough silver would be saved to serve as backing for 25 yuans more of note issue.

- (b) The statement on Page 4 that China imported, from 1922 to 1931, 750,000 ounces of silver is not to be regarded as a basis for a preliminary estimate of the amount of silver coins China may be expected to absorb as money in the future. The situation was different in those years. China was then on the silver standard and the silver kept by people was either in the form of full weight coins, "shoes", or silver bullion and not subsidiary coinage. It is not to be expected that the Chinese public will hoard or accept subsidiary coins as freely as either full weight coins or silver bullion. Moreover, the whole of China in the years 1922 to 1931 is not to be regarded as identical with the area over which the Nanking Government can now enforce circulation of its new coins.
- (c) It is to be noted that the 130 million yuans referred to in the top paragraph on Page V is not to be added to the estimate of 200 million already made on Page 4. According to Mr. Chen, the 200 million includes the coins which are to replace the paper yuans now outstanding.

II

"Memorandum on the question of the independence of Chinese currency."

The explanation offered in this memorandum of the alterations in dollar does not necessarily justify the original step of altering the dollar and keeping sterling fixed when the London-New York cross-rate went up above \$5.00. However, the statement made at the end of Page 6 that China will make another declaration, reiterating her policy of not fixing the yuan to either sterling or the dollar, may be satisfactory.

Better evidence that China intends to pursue that policy would be supplied by a change in the sterling-yuan (official) rate. Mr. Lochhead reports that on May 4th the sterling-yuan rate was altered one-sixteenth while the dollar rate was kept the same; and on the next day both rates were changed slightly. Mr. Chen is going to cable his Government for confirmation of those reported rates.

III

"Memorandum on increasing the liquidity of the cash reserves against note issue of the Chinese Government banks."

1. It is understood that any shipments of silver to the United States will be on American bottoms, under the same conditions as were made for the earlier purchases of silver from China.

Secretary Morgenthau - 5/8/36, 5.

2. If (?) million ounces of silver are to be purchased, the arrangement might include the following conditions:

- (a) Purchases to be made at the rate of (?) million ounces a month for the balance of the year, with the understanding that the agreement is cancellable by either Government on the 15th day of any month, cancellation to apply to purchases after the end of the month.

The monthly amounts are not to be cumulative. If the Chinese Government should contract to sell less than (?) million ounces any month, the difference shall not be added to the purchases to be made in subsequent months. The sale is to be understood as completed during the month in which the silver is placed on board ship at Shanghai.

- (b) The price to be paid for the silver is to be the price offered by the Treasury on the 15th day of each month, the Chinese Government being free to sell or not, as it deems fit, at the price quoted.

3. If credit is to be offered to the Chinese, it is suggested that the conditions be as follows:

- (a) The privilege of a credit to remain during the remainder of this year. If the Chinese wish, they may, a month and a half before expiration, renew negotiations for consideration of an extension.
- (b) The interest rate is to be 2 per cent.

The justification of this low rate of interest is:

- (1') It constitutes a reward for Chinese endeavor to co-operate in the expansion of the use of silver.
 - (2') It provides an incentive for other countries to do likewise if they wish to obtain such accommodation.
 - (3') It provides an adequate return in view of the complete absence of risk involved in the loan.
 - (4') The U. S. Government pays out less than that for its short-term money, and the transaction is to be regarded in the nature of international monetary co-operation rather than an extension of a commercial loan.
- (c) The loan is to be made not against the silver, but against yuan exchange. The silver is to be sent to the United States as further collateral against the loan to the value of 100 per cent of the credit taken up. The silver so sent is to be valued at 40 cents an ounce. This amounts to collateral of 250 per cent when silver is 45 cents an ounce and yuan exchange 30 cents.

OFFICE CORRESPONDENCE

DATE May 6, 1936.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATIONFROM: L. W. KnokeWITH BANK OF ENGLAND.

I called Mr. Bolton at 10:35 today and reverted to our conversation of yesterday. I told him that, as I had already suggested yesterday, our friends would not feel justified to pay a price for gold abroad which, with shipping charges added, would bring the cost of delivery in New York to above \$35 per ounce. I continued that there were several other considerations which made it seem inadvisable to act on his suggestion of yesterday. For us to pay \$34.77 in Paris, quite apart from the fact that it would bring the cost up to \$35.03 if, subsequently shipment were made to New York, would be equivalent to our selling dollars at 1517 1/2 and that we would then compete with our commercial banks which were now freely taking care of the situation and, at the prevailing dollar rate of 1519, were paying only \$34.73 1/2 per ounce. It had always been the Treasury's policy to avoid competition with our own banks. Moreover, we would presumably act contrary to the wishes of the Bank of France, which we understand has suggested to the banks in Paris that they should not ship gold until the dollar went to 1519. Bolton confessed that he had not looked at it from that point of view. I then pointed out that, as mentioned to him yesterday, our order at \$34.77 plus brokerage for delivery in London, of course, continued to hold. It did not matter, as far as we are concerned, where the gold came from as long as we did not pay more for delivery in London than our limit of \$34.77 plus brokerage. Bolton inquired whether \$34.77 represented the net outturn which the gold shipper received in New York and I replied that, according to all our calculations, anybody paying more than \$34.77 for delivery in London must be

OFFICE CORRESPONDENCE

DATE May 6, 1936.

CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATIONFROM L. W. KnokeWITH BANK OF ENGLAND.

- 2 -

willing to forego even an interest return on the money invested, leave alone any profit on the transaction.

I thanked Bolton for having put the thought up to us. He replied that his suggestion had been intended as a cooperative effort and that he was glad to have had the opportunity to discuss it with me.

I inquired as to market conditions this morning. Bolton thought things looked a shade better; Paris was obviously much less discouraged today. I asked whether this change was based on anything other than sentiment. He thought it was entirely sentimental; last night everybody had expected an embargo on gold to be declared today; this morning they were happy that this had not happened and had read with satisfaction of Regnier's statement that he was not going to put it on. There was an enormous speculative position in the market, Bolton continued, and the British Fund had "put the market up against them a bit this morning." Their operations were so far on a small scale; he had heard only of a small amount of gold having been engaged for shipment to New York.

LWK:KMC

Wednesday
May 6, 1936

Operator: Mr. Cochran:

HMjr: Hello -

H. M.

Cochran: Hello, Mr. Morgenthau -

HMjr: Good morning - what's the news?

C: Have you received - did you get my wires this morning?
I sent one at ten and one at twelve.

HMjr: Hello - No, I have received no wires.

C:

HMjr: I don't hear you.

C: Have you received any wires from me today?

HMjr: None

C: At eleven o'clock this morning -

HMjr: Yes

C: I sent you that last night at the Cabinet meeting -

HMjr: I - we've got a very bad connection this morning.
Hello?

C: Can you hear me now?

HMjr: Talk very slowly.

C: Yes - Last night -

HMjr: Last night?

Operator: Just a minute, please, Secretary, I'll try to get a
(Overseas) better connection for you.

HMjr: How long will it be?

O.O.: Just a few moments.

HMjr: All right. (Pause)

HMjr: Hello -

C: Hello -

HMjr: Yes, Cochran -

C: Can you hear me through?

HMjr: Much better.

C: Last night at the Cabinet meeting Sarraut asked his party to remain in office with him until June first.

HMjr: I see - asked who to remain?

C: The members of his Cabinet.

HMjr: I see.

C: - all of them to remain until June first.

HMjr: Yes

C: With the understanding that in the meantime he will keep in touch and consult with the leaders of the new majority.

HMjr: I see.

C: And at the close of the meeting Regnier, the Minister of Finance -

HMjr: Yes

C: Gave out a statement to the press.

HMjr: He did what?

C: Gave a statement to the press, -

HMjr: Yes, we got that.

C: So you have that?

HMjr: Yes

C: - that just confirmed the information that I had given you before from the Bank of France.

HMjr: Yes

C: But this was the first time they had made any public statement -

HMjr: Yes

C: - the Government since the election.

HMjr: I see.

C: So that has had a very quieting effect.

HMjr: Yes - well, that's all right. Now, - things seem a little quieter then?

C: It did, yes - up until noon. I talked with Cariguel at twelve o'clock -

HMjr: Yes

C: At that time only a quarter of a billion dollars had been sold.

HMjr: Yes - well, that's very good.

C: Yes

HMjr: Yes

C: At three o'clock I spoke with the Guaranty -

HMjr: Yes

C: I was talking with them when you tried to get me first.

HMjr: Yes

C: At three o'clock they had done a little less than two billion dollars.

HMjr: Yes, I see.

C: But business was increasing just a little at that time.

HMjr: Well then, it looks as though the Cabinet would hang on until June one?

C: It all depends, as I said before, upon this monetary situation.

HMjr: I see.

C: - capital outflow -

HMjr: Yes

C: If this statement succeeds in quieting them - the cabin-quieting the capital fright -

HMjr: Yes

C: Then this Cabinet will positively hold on until June frist.

HMjr: I see.

C: They had a special meeting of the Regents of the Bank of France -

HMjr: Yes

C: - at twelve o'clock today.

HMjr: Yes

C: - and raised the bank rate from five to six percent.

HMjr: Yes

C: They had refrained from taking such action -

HMjr: Yes

C: - until Regnier might declare himself.

HMjr: Yes

C: But now that he has given this statement and the situation reacted -

HMjr: Yes

C: - the Bank to do its part, raised the rate.

HMjr: Yes - all right.

C: No - it may be quiet a while now, see?

HMjr: O. K.

C: But I look for it to get nervous again as the first of June approaches. That's fairly possible.

HMjr: Well, that's another life-time.

C: Yes (Laughter) That's plenty of time.

HMjr: All right.

C: Fine

HMjr: O. K.

C: But I'll send you the wireless, you see, if I get something from my friend -

HMjr: Yes

C: Fine

HMjr: Thank you

C: But there are two wires on the way to you now.

HMjr: Well, we'll get them in time.

C: One - in one of them I quoted Parker Willis -
in a cable this morning -

HMjr: Yes

C: - The American stabilization fund was very active
yesterday.

HMjr: Yes

C: He said that it furnished the Bank of France with
great amounts of dollars against the gold - earmarked.

HMjr: Well, Parker Willis is getting old.

C: (Laughter) I think the people here will believe it
pretty soon.

HMjr: I hope so.

C: Yes

HMjr: Thank you.

C: All right, sir

HMjr: Goodbye.



TREASURY DEPARTMENT

117

WASHINGTON

May 6, 1936.

MEMORANDUM FOR THE SECRETARY:

As reported to you verbally, conferences were had this morning with representatives of the Seagram Company and Hiram Walker.

Following our conferences on May 4, the State Department (Messrs. Phillips and Hickerson) was advised (informally by Mr. Whitaker and myself) that the negotiations with the Seagram Company had definitely broken down. A copy of my memorandum of May 4 to you was handed to Mr. Phillips, and I advised him of the intention of the Secretary of the Treasury and the Attorney General immediately to request the Chairman of the Senate Finance Committee to proceed with the pending legislation.

Mr. Phillips made the suggestion that it might be advisable before any final action should be determined upon, for the State Department to call in the Canadian Charge and inform him that unless substantial offers should be made immediately by the Canadian companies the legislation would be proceeded with, Mr. Phillips' purpose being to afford the Canadians one final opportunity, should they desire to have it, to make offers in compromise of the Government's claims against them. Mr. Phillips was advised that there would be no objection on the part of the Treasury Department and the Department of Justice to this course of action.

On Tuesday, May 5, the State Department (Mr. Hickerson) advised the Treasury (Mr. Graves) by telephone that, as the result of the representations made to the Canadians by the State Department pursuant to the foregoing, the Seagram Company desired to reopen negotiations for settlement.

To-day's conferences with Seagrams and Hiram Walker followed, with the results below indicated:

Seagrams.

Mr. Phillips, counsel for the Seagram Company, stated that at his meeting with the Government's conferees on Monday, May 4, he had not

intended to be understood as submitting final offers on behalf of his company; and that he regretted very much that the Government's conferees had so understood him. He said that the Canadian Government was now about to fasten the responsibility for the breakdown of negotiations and for the determination of this Government to proceed with the legislation, upon him and upon his company; and that he did not desire to take such a responsibility. He said that he was, therefore, prepared to enter into further discussions with the Government. He submitted the following offer in settlement of the Government's claim:

The sum of \$1,200,000, to be paid in full on or before January 1, 1937, instalments to be paid at the rate of 30 cents per gallon on all spirits imported into the United States by the Seagram Company, any outstanding balance which might exist on January 1, 1937, to be paid in cash on that date.

Mr. Phillips was careful to say that this was not necessarily the final offer of his company, and that in the event this offer should not be acceptable, he desired to proceed further with the negotiations.

On behalf of the Government, Mr. Whitaker advised Mr. Phillips that his offer was not acceptable, and that it would have to be substantially increased before it could be given favorable consideration.

Mr. Phillips was told that the Government's conferees would receive him at any time up to Monday, May 11, for further discussions; and he asked for, and was given, an appointment for 3:30 to-morrow afternoon (May 7).

At this morning's conference, Mr. Phillips again stated that his company did not consider it practicable to make any offer on alternative No. 2 (jurisdiction and security).

Hiram Walker.

Mr. Lash, for Hiram Walker, repeated to the Government's conferees that his company differed with the Government as to both the facts and the law of the Government's case; and that his company was convinced that it was not in fact liable for any part of the amount of the claim which had been asserted. Mr. Whitaker, on behalf of the Government, agreed that these differences of opinion existed, and suggested to Mr. Lash that for this reason it was the Government's preference that the Walker Company should submit itself to the jurisdiction of our courts, so that there might be a judicial determination of the issues which were involved. He stated that but for the earnest desire of both Governments to avoid objectionable legislation this Government would have insisted upon such a judicial determination; and he suggested that in view of the position now taken by the Walker Company, the best thing which could be done in the interest of both parties would be for the company to agree at this

Memo. for the Secretary—3.

time to submit to the jurisdiction of our courts, and to give security for the payment of any judgment which might be obtained as the result of litigation.

Mr. Lash replied that his company must definitely decline to enter into any such arrangement, but that it was willing to tender an offer in compromise of the claim. He tendered such an offer, as follows:

\$800,000, of which \$200,000 would be paid in cash, the balance to be paid in instalments at the rate of 20 cents per gallon on all spirits imported into the United States by the Hiram Walker Company until full payment had been made.

Mr. Lash was advised that his offer was unacceptable.

While Mr. Lash did not indicate that his company would desire to make a further offer, it is considered likely that this will be done.

GRAVES.

see page 120



COMPTROLLER OF THE CURRENCY

WASHINGTON

May 6, 1936.

Dear Henry:

I was rather surprised yesterday when you advised me in your office that I had violated a rule laid down by the President that all bills should be cleared through the Director of the Budget and that I had introduced bills which had not been cleared.

I am enclosing herewith copies of letters received from Honorable Wayne C. Taylor, Under Secretary of the Treasury, one dated April 20th in which Mr. Taylor cleared two of my bills and gave me permission to introduce them, reserving the right of the Treasury later to object, and an undated letter from Mr. Taylor in which he cleared all of the other bills and returned the drafts of the legislation on the same conditions.

I called Mr. Bell, Director of the Budget, and asked him to give me the number of the bill which was introduced by me without the Budget's approval, and he said that several bills were introduced without the Budget's approval. I told him of my conditional clearance from Under Secretary Taylor, and Mr. Bell said that Mr. Taylor, being new, probably was not familiar with the rule. I told Mr. Bell that of course I felt that when I got a clearance from the Secretary's Office, that was as far as I should go.

I am sure you will be glad to correct your records to this extent.

Cordially yours,

[Handwritten signature]
J. E. T. O'CONNOR
Comptroller

I talked personally to Mr O'Connor about this. JMS

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

C O P Y

Apr. 20, 1936

My dear Mr. O'Connor:

I am returning the drafts of legislation which you forwarded with your two letters to the Secretary of April 16.

If you wish to submit these drafts to Congress at the present time, I shall not object to your doing so, although I am not now in a position to assure you that either of the proposals can be given the Department's approval.

Very truly yours,

/s/ Wayne C. Taylor
Acting Secretary of the Treasury.

Hon. J. F. T. O'Connor
Comptroller of the Currency

C O P Y

My dear Mr. O'Connor:

I am returning the drafts of legislation which you forwarded with your letter to the Secretary of March 31.

If you wish to submit these drafts to Congress at the present time, I shall not object to your doing so, although I am not now in a position to assure you that all of the proposals can be given the Department's approval.

Very truly yours,

/s/ Wayne C. Taylor
Acting Secretary of the Treasury.

Hon. J. F. T. O'Connor
Comptroller of the Currency.

MEMORANDUM RELATIVE TO S. 4513, A BILL TO AMEND THE ACT ENTITLED "AN
ACT TO PROVIDE A NATIONAL CURRENCY SECURED BY A PLEDGE OF UNITED
STATES BONDS AND TO PROVIDE FOR THE CIRCULATION AND REDEMPTION THEREOF."

This bill provides as follows:

1. The Comptroller of the Currency is given unlimited power to make such rules and regulations as he deems necessary for the performance of duties imposed on him by the provisions of laws relating to national banks.

2. "Notwithstanding any other provision of law, the Comptroller of the Currency, in fixing the salaries of Deputy Comptrollers of the Currency, and of other officers and employees who are now or hereafter may be under his direction by virtue of any provision of law, and whose salaries are payable from funds under his control and supervision derived from assessments levied by him or as otherwise provided by law, may apportion their salaries among said funds where they render services in connection with more than one administrative division or branch of the duties and functions imposed by law upon him in any capacity."

Comments.

The provisions conferring unlimited power to the Comptroller relative to the issuance of regulations and rules warrant careful consideration for the following reasons:

1. The Comptroller of the Currency has not previously been given blanket power to issue regulations incident to the performance of his duties. Previous law has authorized him to issue regulations in the following specific cases:
 - a. In the case of a national bank acting as an insurance agent or broker.
 - b. For the computation, assessment, and collection of expenses of examination.
 - c. In connection with banks in conservatorship under the provisions of Section 211 of the Bank Conservation Act.
 - d. In connection with dealing in investment securities by national banks.
 - e. For the purpose of defining "investment securities."
 - f. Providing for the destruction of obsolete plates and type for national bank notes.

3. If this proposed bill were passed it would tend to give legal effect to regulations previously issued by the Comptroller of the Currency without authority.
3. The position of the Federal Deposit Insurance Corporation in its attempts, in the interests of efficiency, to persuade the Comptroller to relax certain of his existing rules pertaining to liquidation of closed banks would be considerably weakened.
4. The natural effect of the passage of this bill would be to increase considerably the regulations issued by the Comptroller.
5. The proposed bill is probably not constitutional in that it does not lay down any standards that would serve to define the limits of the regulations that might be issued, that is, it constitutes a delegation of an unlimited authority to the Comptroller of the Currency.

While the provisions relating to the distribution of salaries of officers and employees under the direction of the Comptroller among various divisions or branches ostensibly apply only to officers and employees actually on the rolls of the Office of the Comptroller of the Currency they may, in fact, be much more far reaching than that, if the Comptroller is able to substantiate his claim that agents of the Federal Deposit Insurance Corporation acting for the Corporation in connection with the liquidation of closed banks are, in fact, agents of the Comptroller of the Currency, the salaries of these employees would in all probability be made subject to the provisions of this law. If it is determined that the Federal Deposit Insurance Corporation is an independent contractor having jurisdiction over its own employees or agents rather than an agent of the Comptroller of the Currency in the liquidation of closed national banks, then this law would probably in no way affect employees of the Corporation.

If these provisions relating to the fixing and distribution of salaries actually are intended to apply only to employees on the rolls of the Office of the Comptroller of the Currency, it would appear that this proposed bill is unnecessary, since such a distribution of expenses should be purely an administrative matter and should not require a law similar to the one proposed.

It appears highly desirable that in order to avoid further conflict between this Corporation and the Comptroller of the Currency, and to eliminate the possibility of additional confusion in the matter of liquidation of closed national banks that the proposed law in its present form not be passed.

C
O
P
Y

125

FARM CREDIT ADMINISTRATION

WASHINGTON, D. C.

April 28, 1936

The Honorable,
The Secretary of the Treasury.

Dear Henry:

The Farm Credit Administration has no convenient garage facilities for its official cars, four of which are kept at Second and Canal Streets and two at Thirteenth Street and Constitution Avenue.

If the building at 406 Thirteenth Street, N. W., which is adjacent to our offices, should become available it would afford very convenient garage facilities, as well as storage space on the upper floors for reserve equipment now stored in Temporary Building F, and for inactive files and miscellaneous supplies now inadequately stored in our office building.

I will very much appreciate your consideration of our needs should the building referred to be vacated.

Sincerely yours,

/s/ W. I. Myers
Governor

Preliminary memorandum on bills recommended by Comptroller of
the Currency.

1. S. 4511, To increase examination fees of District of Columbia Credit Unions: The effect of this proposal would be, certainly with respect to small credit unions, to charge fees greater than the credit unions could stand. I am informed by Farm Credit that the actual cost of examination will run from \$30 to \$50 per examination, an increase of many times over the present average fee of \$5.48, and that no credit unions smaller than \$15,000 could stand this charge.

2. S. 4513, Authorizing the Comptroller to make rules and regulations and to apportion salaries of his employees: The rules and regulations are not subject to approval by the Secretary and the effect of apportionment of salaries while ostensibly designed to permit the cost of the Chief Deputy to be allocated to closed banks on which he is now working exclusively, would actually be to permit the allocation to going banks of the expense of the entire insolvent bank section, the work of which is probably tapering off and will soon be negligible in view of the winding up of receiverships and the activities of Federal Deposit Insurance Corporation.

3. S. 4515, Referring to conversions of state banks into national banks. This amendment would accomplish two things; first, to permit state banks to become national banks with less than the required amount of prescribed capital where they have outstanding capital notes or debentures given to the Reconstruction Finance Corporation, if they give

assurances satisfactory to the Comptroller that they will increase their capital after charter to the required amount and retire their capital notes or debentures; and, second, to abolish double liability on their shareholders when they have so converted. The success of the first proposal will be dependent largely upon the cooperation of the Reconstruction Finance Corporation and we have not yet been advised of their attitude; and the second suggestion has the disadvantage that it unduly encourages state banks to convert since a state bank organized prior to 1933 could by conversion relieve its shareholders of liability, a course not open to a national bank chartered at the same time.

4. The remaining three bills - S. 4510, S. 4512, and S. 4514 are being revised and we have not yet been furnished with the ultimate revision.

O'Connor's Bank Bills Opposed By FDIC; Hearings to Reopen

Long Standing Conflict Renewed on Comptroller's Jurisdiction in Re- ceiverships

From THE WALL STREET JOURNAL Washington Bureau

WASHINGTON—The long standing conflict between the Federal Deposit Insurance Corp. and the office of the Comptroller of the Currency for increased jurisdiction over the nation's banking system Tuesday showed promise of breaking into the open before the end of the week.

A general reopening of this issue which has smoldered with intermittent outbursts since the inception of the Deposit Insurance Corp. was pointed to when the House Banking and Currency Committee announced that, at the request of the FDIC, it will reopen hearings on the banking legislation recommended by Comptroller J. F. T. O'Connor.

The banking bill, which would give the comptroller new and increased powers over banks in receivership, was ordered reported to the House last week by the committee. The committee's decision to reconsider the measure is tantamount to a rescission of its favorable report on the measure.

Members of the committee said that the FDIC has raised objections to a provision which would give preferential treatment to those shareholders in banks in receivership who have paid up their assessments and permit them at the discretion of the comptroller to select an agent to replace the receiver after all claims have been settled. The FDIC, it was said, feels that unless special provision is made its claims against residual assets might be jeopardized by such treatment.

There is some sentiment in the committee to revise the legislation to give the FDIC power to examine national banks. Under existing laws, the office of the comptroller is the only agency with this power. The FDIC feels that since it insures these banks and carries the risks, it should have a part in determining when failing banks should be closed and should be permitted to make examinations.

The committee plans to reopen the hearings on Wednesday or Thursday. Leo T. Crowley, chairman of the FDIC, and Comptroller of the Currency O'Connor are scheduled to appear.

When the hearings were first held, Mr. O'Connor was the only witness to testify before the committee, with the FDIC being left out completely.

Major Banking Law Changes Not Expected To Be Made by Congress at This Session; O'Connor Offers Committee Five Minor Bills

BY CARLTON SKINNER

WASHINGTON—Statements by the two senators with a large degree of control over banking legislation indicate that no changes will be made in banking laws at this session of Congress.

Senator Carter Glass, (Dem., Va.), chairman of the subcommittee on monetary policy, banking and deposit insurance of the Senate Banking and Currency Committee, declared there is a "decided probability" that no banking bills will be passed by the Senate. Referring critically to his experience in the last few sessions, Glass said, "They no sooner get the ink dry on one bill than they start to write another." He said there were no important bills before his subcommittee nor was there any need for a banking bill this year.

Senator Duncan U. Fletcher, (Dem., Fla.)

chairman of the Banking & Currency Committee, said he saw no reason for banking legislation, although he had no objection to passage of five small bills submitted to the committee by Comptroller of the Currency O'Connor.

One bill would permit national banks to declare dividends on common stock at any time instead of on a semi-annual basis as is now required.

Another would require national banks to transfer earnings to surplus every six months, whether or not any dividends are declared, until surplus equals 100% of common capital.

A third would allow the Comptroller of the Currency to treat capital notes and debentures of state banks as preferred and common stocks not subject to double liability in cases in which the state bank is converted into a national one provided an exchange is effected after conversion is completed.

A bill which might induce state banks to enter the national system is one allowing converting state bank to be treated as newly-chartered institutions, with its stock not subject to the double liability.

The final proposal would give preferential treatment to shareholders in closed national banks who have paid stock assessments levied by the comptroller in cases where liabilities exceeded assets.

The five bills did not go through the Treasury channels. A report is still to come from Secretary Morgenthau and there is as yet no indication whether or not it will be favorable. At the only hearing on them to date, Robert V. Fleming, president of the American Bankers Association, recommended minor changes in phrasing, which would make them satisfactory to him.

Wednesday
May 6, 1936

129A

Leo T.
Crowley: Yes

HMjr: I got a message from your office and then I spoke to
Jesse Jones about your being over there at eleven.

C: Yes

HMjr: I called up McIntyre and McIntyre said he'd rather that
you didn't come but that you hold yourself in readiness
at the office, see?

C: Thank you, I'll do that, Mr. Secretary.

HMjr: If you'd stay around your office from eleven until
twelve in case we'd want you, but he said he'd rather
first sit down with Jones and O'Connor and myself.

C: That's perfectly all right. I want you to keep this
in mind, Mr. Secretary, of course, that that gives that
fellow a chance to make a lot of accusations that puts
me more or less in a position that I have to substantiate
everything he says, but I know you understand that.

HMjr: Well, this is the way McIntyre wants it.

C: Sure, I know that.

HMjr: And -

C: I'll be very happy and I'll be at the office - if you
want me call me.

HMjr: All right.

C: Thank you.

HMjr: Thank you.

Wednesday
May 6, 1936

129B

HMjr: Hello - hello - hello -

Operator: Secretary Morgenthau, Mr. Jones -

HMjr: Put him on, please.

Operator: All right, he's on.

HMjr: Hello

Jesse

Jones: -Henry?

HMjr: Yes

J: What do you think about meeting in your office?

HMjr: Well, I think McIntyre wants us over there, doesn't he?

J: All right - I just hadn't any choice - I thought maybe -

HMjr: Well, we could - I go in the back way so they don't see me.

J: You go in the back way?

HMjr: Do you know how to do that?

J: What?

HMjr: Do you know the way to go in through the back?

J: No - is that - how do you do that?

HMjr: Well, if you'd come over to my office we'll walk over together.

J: All right. I'll tell you what -

HMjr: And then nobody sees you. You can get to the Cabinet room from the Treasury without anybody knowing it.

J: I see. Then I'll tell you, I'll come to your office - at what time are we leaving?

HMjr: Five minutes of eleven -

J: All right, I'll be over there at five minutes of eleven.

HMjr: And I spoke to McIntyre and he said he distinctly does not want Crowley there.

J: He did not want him?

HMjr: No

J: So - all right.

HMjr: I've had a call in for Crowley. He's stepped out, but I am going to tell Crowley.

J: All right.

HMjr: See?

J: All right.

HMjr: If you'll be here at five minutes of eleven we can walk over and then nobody sees us.

J: All right.

Wednesday
May 6, 1936

HMjr: What's all this telephoning that you are doing about Crowley?

M. J. Fox: Well, I hope I'm not messing anything up.

HMjr: Well, - why are you in it at all?

F: Well, because, I thought if there was anything there that you want to know you'd have an opportunity to go over this statement. You told me once before you had an opportunity to go over the statement.

HMjr: Well, what statement?

F: That statement of the Legislative - between O'Connor and

HMjr: But Tim, why do you interject yourself into this thing?

F: I didn't want to.

HMjr: Well, were you asked to?

F: No - no

HMjr: You were not asked to?

F: No

HMjr: Well then for heaven's sakes use a little sense.

F: All right.

HMjr: I mean, if you weren't asked to, keep out of it.

F: All right, sir.

HMjr: And if Crowley wants to talk to me let him call me.

F: All right.

HMjr: But use a little horse sense will you please?

F: Well, I asked him to call you and he won't do it.

HMjr: Well, all right

F: All right -

HMjr: Use a little horse sense.

14E

F: All right.

HMjr: All right.

May 7th - 1934

130

Saw the President about the CCC camps. I strongly urged the President not to raise the limit of families with incomes of \$500, first, because that would take away his best argument that employment is decreasing in the country and, second, because I was most fearful that he would extend the qualification for what is an unemployed family generally. He promised me he would not do it.

On Hopkins being out of money - I showed him Bell's figures that Hopkins would be short \$23,000,000 on July 1 (statements attached herewith).* I suggested that he take 5% of the unobligated funds which would produce a little over \$30,000,000. He balked quite hard at this and said, "it might do a great injustice to the CCC camps where they set aside unobligated funds to buy food". I said, "well supposing they have, you will have a leeway of \$7,000,000 and you could reallocate some of this money to any agency where you have done them a grave injustice by taking the money away". He said, "that is right". I said, "shall I have Bell draw up the letters" and he said, "yes" so I asked him whether Hopkins, Bell and I could see him after Cabinet and close the whole thing up at that time. He said, "yes".

I did not give him the letter which I had prepared for his signature and which was addressed to me taking off the red tape on the Hopkins obligations because I wanted him to sign it this afternoon simultaneously when he signed the letters to the agencies taking away the 5%.

He said, "tell Bell that I would like him to make a study of all the unobligated funds in the regular departments as they exist to-day in the present fiscal year just as we did in Albany". I also told Bell to make recommendations to the President as to what unobligated funds in the regular department I can cancel.

I again spoke to him about the tremendous importance of his being able to say on July 1st that he had not touched one single cent out of the billion and a half and I have him now completely sold on this idea. He likes it.

I said to the President, "I am being pushed a little bit hard this week" and he said, "so am I because I have had too many conferences and I am just a little tired".

* See diary of May 8th for attachments.

May 8, 1938

HM, Jr. today had a meeting with Hopkins and Bell.

The Secretary said to Hopkins, "I told you the other day, Harry, that I considered it very important that not one cent of the \$1,500,000,000 be obligated or spent before July 1. The President is now completely sold on that. Bell tells me that after you left here, you and he were \$25,000,000 apart. I do not want to say that you should spend \$25,000,000 less, so in order to get this money for you I gave the President a scheme and he is going to sign a letter to every agency taking 5% away from them of their unobligated funds, which will give you \$30,000,000. (The unobligated balances are \$815,000,000, 5% of which is \$30,000,000.) I want you to give me your word of honor that if we do this, you will not come back to me and say, You must give me part of the \$1,500,000,000." Harry said O.K.

HM, Jr. said to Mr. Hopkins, "This is what I do not want -- 50,000 men at work in the last two weeks in June who will be paid out of the \$1,500,000,000 after July 1." To which Mr. Hopkins replied, "What you are talking about are the obligations. On June 30, you have obligated the payroll to July 15 so it is into the next fiscal year." Bell said, "You want to run up to June 30 on the 4 billion 8 money, but he cannot go out before July 1 and buy materials. He has to put in his order prior, but the President can say no material has been taken delivery of and no people have worked or have gotten one cent out of the \$1,500,000,000 before July 1."

Mr. Hopkins then asked Mr. Bell the following: "Dan, tell me how much money we will get before I make a definite promise to Henry. I am to get the \$5,000,000,000 which Dan is holding for me out of the \$47,000,000 and the \$23,000,000 more which will take me through to June 30? If Dan can promise me that, I am prepared to say that I will not use a penny of the \$1,500,000,000."

HM, Jr. then said, "Then we will have no more discussion and this ends it." Hopkins stated to the Secretary, "I will say that this will be done and the unemployed will not suffer. This is my responsibility and not Gill's and I will do it. I agree that none of this money shall be taken out of the \$1,500,000,000."

WORKS PROGRESS ADMINISTRATION

	<u>Unobligated</u>	<u>Unexpended</u>
Balances as of April 20, 1936 - - - - -	\$295.1 M	\$503.3 M
In process of transfer- - - - -	<u>47.</u>	<u>47</u>
Available - - - - -	\$342.1 M	\$550.3 M

Estimated requirements:

	<u>For</u> <u>obligation</u>	<u>For</u> <u>expenditure</u>		
April 20-30 - - -	\$55 M	\$65 M		
May - - - - -	160	170		
June- - - - -	<u>150</u>	<u>160</u>	<u>365.</u>	<u>395</u>
Short for obligation			\$ 23.1 M	
Available for expenditure June 30				\$155.3 M

DWB

OK
10/11/71

UNOBLIGATED AND UNEXPENDED BALANCES OF \$4,880 M, EXCLUDING
WORKS PROGRESS ADMINISTRATION, AS OF APRIL 30, 1956

		<u>5%</u>	<u>4%</u>	<u>3%</u>	<u>2%</u>
Unobligated balances	\$615.7M	\$30.8	\$24.6	\$18.5	\$12.3
Unexpended balances	1,379.5	69.0	55.2	41.4	27.6

sub

1. For example aty servers -
 n. i. R. A. money received from
 Jakes - also loans from sale of
 securities by Jakes -

8.216	6.212	8.214	6.002	-7.0100	Account Debit
8.71	8.12	8.00	6.00	8.000.1	Account Debit

Final

May 7 1936

CONFIDENTIAL

My dear Mr. Secretary:

Pending the availability of additional funds, to be provided by the appropriation now before the Congress, to carry on the Works Progress Administration program it is necessary to obtain a substantial amount from funds previously allocated from the appropriation contained in the Emergency Relief Appropriation Act of 1935.

It is requested that you immediately make available for re-transfer to said appropriation an amount equal to 5% of the aggregate of the unobligated balances, as of April 30, 1936, of all allocations heretofore made from said appropriation for work coming under your jurisdiction, including funds allocated for administrative expenses.

Please advise me in detail not later than May 11, 1936, the amount which will be available for this purpose. Your reply should indicate the exact amount to be taken from each project, designated by the official project number assigned in the letter making the original allocation, and should contain the statement that the amount under each project is unobligated and unencumbered, and available for transfer back to the original account.

Sincerely yours,

(Signed) Franklin D. Roosevelt.

The Honorable,

The Secretary of the Treasury.

The above letter was also sent to the following:

Secretary of Agriculture
" " Commerce
" " Interior
Attorney General
Secretary of Labor
Secretary of the Navy
Secretary of War
Chairman, Alley Dwelling Auth. for D.C.
Chairman, U.S. Employees' Compensation
Comptroller General of the U.S.
Director, Emergency Conservation Work
Administrator, Federal Emergency Ad. of P.W.
(Actg.) Executive Director, National Emergency Council
Chairman, National Resources Committee
Chairman, Prison Industries Reorganization Administration
Administrator, Resettlement Administration
Administrator, Rural Electrification Administration
Administrator of Veterans Affairs, Veterans Admin.

TREASURY DEPARTMENT
Washington

135

Office of
The Secretary

May 8, 1936

CONFIDENTIAL

To Heads of Bureaus and Offices Having Allotments
Under The Emergency Appropriation Act of 1936.

The President under date of May 7, 1936 requested that the Secretary of the Treasury make available for retransfer to the appropriation contained in the Emergency Relief Appropriation Act of 1936, an amount equal to five per-cent of the aggregate of the unobligated balances as of April 30, 1936 of all allocations heretofore made from the said appropriation for work owing under his jurisdiction, including funds allocated for administrative expense, to carry on the Works Progress Administration program pending the availability of additional funds to be provided by the appropriation now before the Congress.

You are requested to advise the Budget Officer not later than May 8, 1936, the amount which will be available for this purpose from the allotment made to your office from the above mentioned appropriation. Your reply should indicate the exact amount to be taken from each project designated by the official project number assigned in the letter making the original allocation, and should contain the statement that the amount under each project is unobligated and unencumbered, and available for transfer back to the original account.

By direction of the Secretary:

Very truly yours,

W. H. MOREYHOLDS,
Administrative Assistant
to the Secretary.

May 7, 1936

HM, Jr. talked to the President at 9:15 and said, "I have been unable to get Paris. Things look a little bit quieter. The Bank of France put their discount rate up to 6%, which is the orthodox defense of the gold standard. Sterling is a little bit steadier. It is 4.96."

He reported to the President that the Federal Reserve Bank of New York had turned over to the Treasury a copy of cable which the Bankers Trust Company of New York had furnished to the Federal Reserve. This cable came from the London office of the Bankers Trust and asked whether gold could be shipped from the United States to Great Britain by new regulations of the Secretary of the Treasury or whether further legislation would be necessary to permit such shipments. The Treasury opinion, he told the President, is that regulations could be promulgated without further legislation, but, he added, "This is very significant."

He also reported to the President that the Federal Reserve Bank of New York had received a call direct from the Bank of England in connection with our standing order with them to buy gold at \$34.77 an ounce, whether we would be interested -- in order to divert some of the present flow from Europe to New York -- in having the Bank of England buy gold for United States account in Paris at \$34.77 plus cost of shipment from Paris to London, or a total of \$34.80 an ounce, this gold to be held in London for U.S. Account. HM, Jr. told the President that our answer was "Our price is \$34.77 and we do not care whose gold it is. If we paid \$34.80 it would cost us over \$35.00 delivered in New York." (Report of Mr. Knoke, of the Federal Reserve, covering the telephone conversation with the Bank of England is filed under date of May 5.)

HM, Jr. said to the President, "In one day, we had those two feelers. In other words, they are looking which way to turn in case France goes off gold."

The President then said to HM, Jr.: "On that 1933 London Economic Conference file, I have gone over it and I have decided that I should not let these files out of my hands. I, therefore, suggest that you come over sometime and read it here." HM, Jr. replied, "I now have a confidential file that Woodin handed to Bell when he left here which is full of information in regard to Warburg and Douglas."

HM, Jr. asked the President to give him an appointment tomorrow morning. "I would like you to give me a final yes or no on the amount of Chinese silver that we are going to buy," he told the President.

HM, Jr. also told the President that he saw Harry Hopkins yesterday and "if we took off all the red tape he is short \$80,000,000. He would need \$80,000,000 more to go to July 1. He would have to take \$80,000,000 out of the \$1,500,000,000. Harry has come down to being short only \$25,000,000 and he is coming back again tomorrow. Before we agree to take off the limitations, he will have to say that he has enough money out of the \$4,800,000,000 to last him until July 1."

136 B

COPY

CABLE RECEIVED FROM BANKERS TRUST COMPANY, LONDON

London, England,
May 5, 1936

COULD BANK OF ENGLAND BE INCLUDED FOR GOLD SHIPMENTS
FROM AMERICA BY SECRETARY TREASURY REGULATION OR IS AMENDING
LEGISLATION NECESSARY?

May 7, 1938

The Mexican Ambassador, Mr. Najera, came in today to discuss with HM, Jr. the proposal of the Mexican Secretary of the Treasury, Mr. Suarez, transmitted to Secretary Morgenthau in Mr. Najera's letter of April 30. Mr. Suarez' memorandum and Mr. Najera's letter are attached. Taylor and Lockheed were present.

The following conversation took place:

HM, Jr.: Mr. Ambassador, I got your letter from our good friend, Mr. Suarez, and I have been a little slow this time, for two reasons. The last time we talked and we entered into this agreement, which so far has worked very nicely, I kept bringing to Mr. Suarez' attention that I thought Mexico, as the biggest producer of silver in the world, should do something for silver inside of Mexico. Up to today, nothing has happened.

Ambassador: He wants to do.

HM, Jr.: He wants to do if we do something more. But I sort of feel that on the agreement which we made -- the first agreement -- that that ought to have been enough help; that he should have shown some move on the part of the Government that they were going to do something to use more silver in Mexico. Up to date, nothing has happened and I think before we go into another conference it might be nice if the Mexican Government showed that besides selling silver, they were interested in using it.

Ambassador: He is going to put in circulation now more quantity.

HM, Jr.: He spoke of that the last time he was here; that he would take it under advisement, and I brought it to his attention that they might again coin some new silver pesos on a new basis and, as I understood, they still have 100,000,000 old pesos out which the people did not want to give up in place of money and that they might be exchanged for new pesos. I think they don't need help from anybody.

Ambassador: These old pesos are in circulation in Yucatan; not possible to exchange them.

HM, Jr.: I have not looked it up recently, but you had

-2-

200,000,000 paper pesos in circulation and we kept taking and taking, and all I can do is to suggest, but it would be nice if the biggest producer -- Mexico, would show the world that they had some use for silver because they keep telling me that Mexico has paper money and Mexico does not use silver and why should anyone else?

Ambassador: I think it is possible to do that.

HM, Jr.: But I would like them to show a little interest; help me to carry the burden of the world silver.

Ambassador: Well, I will talk to him.

HM, Jr.: Suppose you have a talk with him and say I am a little disappointed because I think it would be a great mistake if he came here and then it was a failure.

Ambassador: Yes. I was talking with him day before yesterday and he said that he is supposed to come about last ten days of this month, if it is possible to do something.

HM, Jr.: Why don't you tell him of this conversation?

Ambassador: I want to do that.

HM, Jr.: Tell him I am a little disappointed.

Ambassador: All right.

HM, Jr.: I had hoped that something would have been done before this.

Ambassador: What do you suggest? I think he will ask for further suggestions.

HM, Jr.: I don't know what to suggest. I just left it this way when he was here, that the Mexican Government should show sufficient interest in silver that they should increase the use of it internally. How they should do it, I did not want to suggest to them.

Ambassador: I see. He wants to do, but he can't.

HM, Jr.: I can't make him do it. I don't want to go

-5-

so far as suggest.

Ambassador: I want to talk with him and I will tell him what is your opinion and that if he can find something to -- then if not, this is not the opportunity for him to come now.

HM, Jr.: Not unless he can give me some indication, because he has had three or four months to think this thing over and nothing has happened. You remember, we brought it up and made them a loan on 11,000,000 ounces, but let Mexico show a little interest.

Ambassador: I don't know what the situation is down there.

HM, Jr.: But it would be much better for us to have these preliminary conferences than to have him come here and the newspapers would ask you and ask me to say what happened and we would say, Nothing has happened. The friendship between the two countries is at stake and it's too big a risk to take to have him come up until we know more what he can do. I don't want to take that responsibility, because when he left everything was fine. Everything is fine now. And he comes up and he has certain ideas and we can't meet them and then it would be unfortunate.

Ambassador: I am going to talk to him right away and see what, after this conversation, he is going to do.

HM, Jr.: Yes; see what he can do.

Ambassador: He is anxious to do something, but I think he cannot.

HM, Jr.: Then, if you will give me a ring, I will be delighted to see you again.

Ambassador: All right. After I talk to him, I will see you.

PERSONAL.

BAJADA DE MEXICO

Washington, D. C.,
April 30, 1936.Hon. Henry Morgenthau, Jr.,
Secretary of the Treasury,
Washington, D. C.

My dear Mr. Secretary:

I take pleasure in sending you herewith a memorandum, written in Spanish, which your colleague and friend, Secretary of the Treasury Suarez, has asked me to bring to your personal and friendly attention.

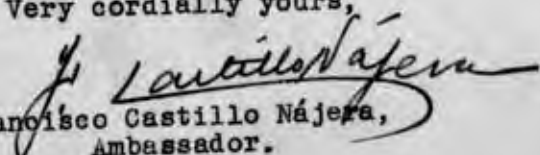
I take the liberty of enclosing a translation of said memorandum, made by this Embassy; but you may, of course, have your staff make another translation of same document, for greater accuracy.

It is useless to say here that Secretary Suarez, speaking in behalf of my government, concedes to this matter an unusual importance.

Secretary Suarez wants me to tell you, furthermore, that in case you be interested in this proposition, he himself, or the Director of the Banco de Mexico, would be glad to come to Washington, in order to make any final arrangements.

Thanking you, once more, for the friendly interest with which you have followed, since the beginning, the development of this matter; and thanking you also for the attention you might give to this particular proposition, I remain, my dear Mr. Secretary,

Very cordially yours,


Francisco Castillo Nájera,
Ambassador.

MEMORANDUM

1) As a result of high silver prices in the world markets recorded a year ago, the Mexican Government had to retire by law the silver currency then in circulation, to replace it with other coins that would not be subject to the danger of being melted and exported by private individuals.

2) Such measure, obviously a necessary one, meant the demonetization of appreciable quantities of silver and their incorporation into the reserve that the country has to regulate foreign exchange.

3) These two steps have resulted in evident difficulties, which the Government of Mexico should like to eliminate by reorganizing on a better basis both the monetary system and the Institution acting as the Central Bank of the Nation. In this manner it would be possible to give to silver its monetary use, in harmony with the practices that are being accepted as the only ones compatible with the requirements of a Central Bank capable of exercising its functions as to exchange and a well proportioned and adaptable circulation.

4) For this purpose, the Mexican Government plans:

a) To mint again One Peso silver coins to take the place of present One Peso certificates;

b) To issue Five Peso silver certificates that would replace present Five Peso notes. These new bills would represent coined or bullion silver deposited at the Bank of Mexico, and the issue of paper currency in denominations under ten pesos would be forbidden;

c) To substitute present 50¢ coins containing 3.3488 grammes of pure silver (0.420), by new ones with a higher silver contents; and

d) To allow coined or bullion silver to form part of the Reserve of the Central Bank. The latter would be authorized to acquire silver up to 25% of its gold and foreign currency in stock, plus fifteen million Pesos additional.

5) So that the new silver coins and the silver backing the certificates may be protected from another appreciable rise in the price of the metal, the monetary relation selected for the minting of the coins and the issuance of the certificates would be that of eight grammes of pure silver per Peso, Mexican currency. This would bring the "silver melting point" up to a level commensurate with silver prices higher than \$1.07 U.S.Cy. an ounce, as long as the present rate of dollar exchange is maintained for the Mexican Peso.

6) Adoption of the above plan would enable the Mexican Government to turn back in a short time to its former monetary use some fifty-eight million ounces of silver, which is all circulation itself could absorb for the time being, for that means currency amounting to approximately 235 millions of Pesos in 50¢ and One Peso coins and Five Peso certificates. Furthermore, after completion of the silver sale transaction outlined below, the plan would make it possible for the Bank of Mexico to include about 35 million ounces in its Reserve.

7) The very nature of the above measures and of those to perfect the plan, demands a more solid Reserve, i.e., a readjustment of present proportions between gold and foreign currency on the one hand, and coined or bullion silver in such Reserve on the other; that readjustment to be made by selling the silver surplus. Besides, unless this last step is taken, the Bank would find it difficult to attempt to retire old silver coins that are still in circulation, for remonetization thereafter.

8) These are the reasons for the Government of Mexico to propose to sell some 60 million ounces of silver, in such a way as not to hurt either the market or present agreements and measures to regulate and support it. On the other hand, it is the belief of

the Government of Mexico that the reorganization of its monetary system, as per the ideas outlined above, will not fail to result in influencing favorably the possibilities of stabilization of that market and even its recovery, partially at least.

9) The Balance of Payments of Mexico often is highly unfavorable, particularly in times of depression, due to the nature and sources of its trade as well as to its position as a debtor nation. This makes imperative the necessity of a solid Reserve, so constituted that without any appreciable loss the Central Bank may at all times dispose of important amounts out of the resources of said Reserve. To attain this purpose, and in view of present silver market conditions, purchases of the metal by the Bank of Mexico would have to be limited to the minimum, unless the Bank were to have a special fund in order to absorb the losses caused by the adjustment of its Reserve to legal proportions between its gold resources and its silver stock, should a heavy drainage occur.

10) The above explains why in order to carry out this plan it is necessary to sell the silver surplus at a price that would furnish the Mexican Government with the means to establish the special fund in question. The Government of Mexico looks forward to

securing a price considerably higher than those prevailing today in the international markets, both, due to the above, as well as in view of the improvement bound to result from these measures for the conditions of said markets.

EA.

MEMORANDUM.

1.- Debido a los altos precios que alcanzó la plata hace un año en el mercado mundial, el Gobierno de México tuvo que decretar el retiro de las monedas de ese metal que se encontraban en circulación, para sustituirlas por otras que no estuvieran expuestas al peligro de ser fundidas y exportadas por los particulares.

2.- Dicha medida, necesaria a todas luces, se tradujo en la desmonetización de importantes cantidades de plata y en su incorporación a la Reserva de que el país dispone para regular sus cambios sobre el exterior.

3.- Ambas consecuencias presentan inconvenientes obvios, que el Gobierno de México desearía remover, reorganizando, sobre mejores bases, el sistema monetario y la institución que funge como Banco Central de la Nación, para dar cabida a la utilización monetaria de la plata conforme a las prácticas que tienden a ser consideradas como las únicas compatibles con las exigencias de un Banco Central capacitado para atender su función cambiaria, y de una circulación bien proporcionada y elástica.

4.- Al efecto, el Gobierno de México proyecta: (1) la reacuñación de monedas de un peso, en substitución de los actuales billetes de esa misma denominación; (2) la emisión de certificados-plata con valor de cinco pesos, que vendrían a reemplazar a los billetes de igual importe y que representarían plata amonedada o en barras depositada en el Banco de México, quedando prohibida la emisión de billetes con denominación menor de diez pesos; (3) la substitución de las monedas de cincuenta centavos con contenido de grms. 3.3488 de plata pura y ley de 0.420, por piezas de ley más fina y mayor contenido de plata; y (4) la admisión de plata amonedada o en barras como parte de la Reserva Cambiaria del Banco Central, el que quedaría autorizado para adquirir plata por valor hasta de un veinticinco por ciento del de sus existencias en oro y divisas reunidas, libres de gravámenes, y quince millones de pesos más.

5.- Para que las nuevas piezas de plata y la plata representada por certificados queden a cubierto de otra alza fuerte en el precio de ese metal, la relación monetaria escogida para la acuñación de las primeras y la emisión de los segundos es de ocho gramos de plata pura por cada peso, moneda

moneda nacional, lo que elevaría el "melting silver point" al nivel correspondiente a precios superiores a Dls. 1.07 la onza troy de fino, mientras se mantenga el tipo de cambio actual del peso, moneda de México, respecto del dólar moneda americana.

6.- La adopción del plan expuesto permitiría al Gobierno de México devolver en poco tiempo su uso monetario anterior a unas Oz. 58.000,000 de plata, que es todo lo que por ahora podría absorber la circulación propiamente dicha, pues representa signos de cambio por valor de unos \$ 225.000,000, en las especies correspondientes, o sea en monedas de cincuenta centavos y un peso y en certificados de cinco pesos. Además, con el complemento de la operación de venta de plata que después se menciona, dicho plan pondría al Banco de México en condiciones de incluir en su Reserva Cambiaria alrededor de Oz. 35.000,000.

7.- La índole misma de las medidas anteriores y de las destinadas a completarlas exige una más sólida Reserva Cambiaria, o lo que es igual un reajuste de las proporciones que actualmente guardan entre sí el oro y las divisas libres de gravámenes, por una parte, y por otra la plata amonedada o en barras pertenecientes a dicha Reserva, mediante la venta de la plata sobrante. Sin esta última medida, además, resultaría inconveniente para el Banco intentar el retiro, para su ulterior remonetización, de las piezas antiguas de plata que todavía se encuentran en circulación.

8.- Esas son las razones por las cuales el Gobierno de México pretende vender unas Oz. 60.000,000 de plata, en forma que lesione lo menos posible la situación del mercado respectivo y los arreglos y medidas destinados a regularlo y sostenerlo. Orde por otra parte dicho Gobierno que la reorganización del sistema monetario de México, conforme a las ideas arriba consignadas, no dejará de producir una influencia benéfica en las perspectivas de estabilización, y aun de recuperación por lo menos parcial, de ese mercado.

9.- La Balanza de Pagos de México suele arrojar fuertes saldos desfavorables, sobre todo en épocas de crisis, debido tanto a la índole y dirección de su comercio como a su posición como país deudor. Eso impone la necesidad de una sólida Reserva Cambiaria y obliga a constituir la de modo que en todo tiempo pueda el Banco Central realizar sin pérdida apreciable una parte importante de los recursos de dicha Reserva. Para conseguir este último resultado, y dada la situación actual del mercado de la plata, sería indispensable limitar mucho las compras de ese metal por el Banco de México, a menos que el mismo dispusiera de un fondo destinado

destinado a absorber las pérdidas ocasionadas por el ajuste de su Reserva Cambiaria a las proporciones establecidas por la ley entre sus recursos en oro y sus existencias en plata, en el caso de un fuerte drenaje cambiario.

10.- El anterior es el motivo por el cual la aplicación del plan expuesto arriba exige la venta de la plata sobrante a un precio capaz de proporcionar al Gobierno de México los medios necesarios para constituir dicho fondo de previsión, y tal Gobierno espera obtener un precio sensiblemente superior a los que hoy prevalecen en el mercado internacional, tanto en esa virtud como en consideración a la mejoría que no pueden menos de producir en las condiciones de dicho mercado las medidas previstas en aquel plan.

-----o-----

Shortly after 5 P.M. the Secretary and Mr. Upham joined a conference in the office of Senator Harrison, Room 217, Senate Office Building. Others present were Senator Harrison, L.H. Parker, Chief of Staff of the Joint Committee on Internal Revenue taxation, Guy T. Helvering, Commissioner of Internal Revenue, Herman Oliphant, General Counsel and George C. Haas, Director of Research and Statistics.

Senator Harrison explained that the last few days of the public hearings on the Revenue Act of 1936, closed today, had produced effective testimony against the House Bill and that many members of the committee were insisting upon definite modification of the proposed tax on undistributed earnings of corporations. He feared that it would be next to impossible to get the House Bill through the Senate Finance Committee. He expressed a wish to keep control of the situation in his own hands and in the hands of the Administration by being prepared to offer an acceptable compromise rather than losing control of the situation to others of the committee through uncompromising insistence on the House Bill. He was of the opinion that it might be profitable to investigate the possibilities of keeping a flat rate tax on corporation income as at present, thus assuring the collection of a substantial amount of revenue and superimposing upon it a graduated or flat tax on undistributed earnings. The figures he used were a 15% flat tax and a 15% super tax. Senator Connally is proposing a 12½% flat tax and a 12½% super tax. Others have an idea of a graduated super tax on undistributed earnings.

Senator Harrison is of the opinion that such a plan would keep the principle of the President's proposal without running the risks

to the revenue and to the corporations which are involved in the House Bill.

Commissioner Helvering seemed willing to give consideration to the compromise bill.

Mr. Parker was of the opinion that there was some advantages to taking the President's proposal for a tax on undistributed earnings on corporations in "two bites", and expressed the viewpoint that there are a great many uncertainties about the present bill which must remain uncertainties and cannot be definitely forecast.

Mr. Haas agreed that the compromise proposal would produce revenue.

Mr. Oliphant argued against abandoning the tax on undistributed earnings and reiterated his position that the area of taxation which should be exploited is the income of corporations which are owned by persons who would have to pay a personal income tax in the high bracket on such corporate earnings if they were distributed. He referred to the present holding companies and incorporated pocket-books and to the fact that the Pecora investigation and others had brought to the notice of the country that a great many exceedingly rich men paid no income tax and give no support to the Government. As he put it, the pending bill does not increase taxes; it stops tax avoidance. Many of the small taxpayers will pay less taxes and many corporations will pay less taxes or nothing at all.

Mr. Oliphant also referred to the propaganda which plays up a large percentage of tax under the House bill to the retained portion of earnings. He demonstrated that even greater percentages of tax to retained earnings exist under the present law.

Mr. Oliphant was further of the opinion that the President and

the party are now so committed to a tax on tax avoiders through a forced distribution of corporation earnings that to abandon it at this stage would give political opponents an opportunity to denounce and ridicule the President for having abandoned a major principle of merit.

Senator Harrison said that he was not worried about the political aspect of that and remarked that he could use on the floor of the Senate, in support of the modified plan, the identical arguments used by the President in favor of the proposal embodied in the House Bill.

Mr. Morgenthau excused himself from the conference after half an hour stating that he was too exhausted physically to be able to contribute much to the discussion, but expressing his readiness to discuss the matter further at a later time and accompany Senator Harrison to the White House for a decision. (Mr. Morgenthau later stated to the Treasury group that he had been unwilling to indicate by "even the flicker of an eye lash" his reaction to the Harrison suggestion prior to further discussion with the Treasury group and with the White House. It was for that reason that he preferred to postpone his discussion of the matter until later).

The rest of the group continued the discussion for some time.

Senator Harrison expressed doubts about the amounts that would be collected under the windfall tax.

Senator Harrison said that Secretary Wallace would appear before the Committee on Monday.

Senator Harrison asked for Treasury estimates on revisions of the House Bill. He suggested that the testimony of certain witnesses, particularly Mr. Ballantine, Mr. Sargent and Mr. May be reviewed by the Treasury for the presentation of answering arguments in the Executive Sessions of the Committee which begin on Monday, May 11th.

May 7, 1936

My dear Senator:

Yesterday, part of the statement which I made before your Committee on April 30 was challenged. The particular part of the statement was the following:

"The Department has also estimated that under the present law more than four and one-half billion dollars of corporation income in the calendar year 1936 will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional individual income taxes would be about one billion three hundred millions."

I can see that the phrase "withheld from stockholders" was possibly open to misunderstanding inasmuch as the figure \$1,500,000,000 was arrived at after we had deducted from the \$4,500,000,000 an amount equal to the existing corporation taxes.

What I have just said about a possible ambiguity in the use of this term relates to one of my arguments on the merits of the proposed corporate tax, not at all to my statement of the Treasury's estimate of what this tax would yield. That estimate is 623 million dollars additional revenue.

Sincerely yours,

Secretary of the Treasury.

Honorable Pat Harrison,
Chairman, Senate Finance Committee.

DRAFT

(first)

My dear Senator:

Yesterday, part of my statement which I gave before your Committee on April 30 was challenged. The particular statement was the following:

"The Department has also estimated that under the present law more than four and one-half billion dollars of corporation income in the calendar year 1936 will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional individual income taxes would be about one billion three hundred millions."

The statement ^{phrase} "~~will be~~ withheld from stockholders" I can see was possibly open to misunderstanding inasmuch as the figure \$1,300,000,000 was arrived at after we had deducted from the \$4,500,000,000 the present corporation income tax which amounts to \$1,100,000,000.?

I believe that this will clear up any possible misunderstanding as to the use of the term "withheld from stockholders."

Sincerely yours,

What I have just said about a possible ambiguity in the term I used in my statement to your Committee relates to ~~only~~ one of my arguments on the merits of the proposed corporate tax, not at all to my statement of the Treasury's estimate of what this tax would yield. That estimate is 623 million dollars additional revenue.

First

DRAFT

My dear Senator, *Harrison*

Yesterday, part of ~~my~~ ^{*the*} statement which I ~~gave~~ ^{*made*} before your Committee on April 30 was challenged. The particular *part*

of the statement was the following:

"The Department has also estimated that under the present law more than four and one-half billion dollars of corporation income in the calendar year 1938 will be withheld from stockholders and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional individual income taxes would be about one billion three hundred millions."

I can see that phrase
The statement "~~will be withheld from stockholders~~" *I can*

~~see~~ was possibly open to misunderstanding inasmuch as the figure \$1,300,000,000 was arrived at after we had deducted from the \$4,500,000,000 the ~~present corporation income tax which amounts to \$1,100,000,000.~~

I believe that this will clear up any possible misunderstanding as to the use of the term "withheld from stockholders."

Sincerely yours,

~~*[Handwritten signature]*~~

an amt
~~*[Handwritten signature]*~~

an amt

this What I have just said about a possible ambiguity
~~in the term I used in my statement to your Committee~~
relates to ~~only~~ one of my arguments on the merits of the
proposed corporate tax, not at all to my statement of the
Treasury's estimate of what this tax would yield. That
estimate is 623 million dollars additional revenue.

*in the case
of J*

May 7, 1936

PRESS CONFERENCE

Q. Mr. Secretary, there are reports that the Treasury plans to utilize the silver profits for payment of some of this bonus. Wall Street is talking about it.

A. They are always right! No; you will just have to charge that off to another Wall Street rumor, I guess. Nothing in it.

Q. Does it look like you are going to get the job done by the scheduled date?

A. Yes, I am quite sure everything will go out on time. I have seen the figures on what the lag is and each week we are getting nearer and nearer up to date with the number of names which are furnished us by General Hines.

Q. Will you make any comment on Mr. May's charge that the Treasury has underestimated?

A. There is a letter in preparation which I am sending up to Senator Harrison today and it ought to be up there by noon and Senator Harrison said he would give it out up there.

Q. Off the record, can you give us a general idea, without using it until he gets it out?

A. I think, off the record, he did not read all of Mr. Helvering's statement. He took the part which he liked best.

Q. That's in reference to the \$4,500,000,000?

A. Yes. And my figures on the revenue and Mr. Helvering's check. There is no difference.

Q. How about the underestimates, without regard to whether or not there are misstatements?

A. We don't do that. All we have ever done is, when we estimate our revenue we estimate very closely on the conservative side. Our figures over the last two years

prove that our estimates have been as near correct as any human being can make them and -- this is all off the record -- I have never faked any figures since I have been here and you boys know that I am not going to fake them to get a tax bill or anything else.

Q. On this recovery. That was not counted in.

A. No, we took in recovery. They think we have not allowed for business recovery, but we have, absolutely, and our estimates have been within one percent of being right. Let's be practical -- when we made this estimate, last December or last November, no one could guess that Congress would throw this thing out and no one knew we would have the bonus and I sat back and looked into the crystal and knew they would be thrown out. We have to go on the assumption that we faked them when we made them up last December, which is perfectly cock-eyed. The figures are just as correct as anybody could make them. After all, the one thing here is we have to keep the confidence of the public and when the Treasury says something they mean what they say and in order to get a tax bill or anything else I would not fake any figures. We can make honest mistakes. We all make mistakes. Certainly Mr. Mills had to go back on the Hill three times to correct his figures. I have no doubt his mistakes were honest ones, but he had to go back three times, and Mr. Mellon, I think, undershot the mark one year; was off 50%. I am not saying he did it for political reasons. I am saying somebody made a mistake. We have been lucky and our figures are extremely accurate, but don't forget they were made last December.

Q. Does it still stand that the Treasury feels the tax bill will raise more money than existing law?

A. It still stands. Still off the record -- you will get the letter. If Mr. May had read all of Mr. Helvering's statement through, he would have seen that his statement and mine jibe.

Q. Do you still expect this year's deficit to be \$5,788,000,000?

A. Nothing has been brought to my attention, in or out of the Treasury to make me change that figure.

Q. That letter isn't up there yet?

-3-

A. No, it is not finished and it will be 12 or 1 o'clock before it goes up there.

Q. Would it not be necessary to increase the rate of expenditure -- that is, leaving the bonus out of consideration entirely -- to almost double the rate of other monthly expenditures to reach such a deficit figure?

A. I have not any notes here, but as I explained to Bob, the other day, the difference between these estimates is -- the bonus goes on the books of the Treasury as a charge. It does not mean all 2,300,000,000 are going to be cashed, but once they leave our possession they become a charge ...

Q. But I mean other expenditures. General and recovery expenditures at the present monthly rate, if continued during the next two months, would make for a deficit considerably smaller, would it not, than your estimates of last week?

A. Not according to the people in the Treasury who are responsible for those figures and who have been following them every day. These men have been here since I have been here. I have never once given out any fake figures in the Treasury to try to influence any legislation or political situation. I have not done it once and the men who have been here know it is so. I have never intentionally given out any wrong figures. In the first place, it would be most stupid thing I could do and, without trying to make a stump speech, the reason the bond market has gone up and our credit has gone up is that when I make a statement on figures people who put their money in Government bonds have confidence in the Treasury. We all make mistakes, but so far I haven't. The reason the bond market is so healthy is that the figures that have come out since I have been here have been correct and not for some ulterior motive.

Q. On the first of May the total expenditures were about \$6,000,000,000 and if you were going to have a deficit, including a deficit as large as \$5,600,000,000, you would have to spend in addition to the bonus something like \$1,000,000,000 a month if your revenue estimates are correct.

A. You are getting down to spending. The big difference in spending is Agriculture where they have not spend theirs on AAA. I don't know when Wallace will suddenly open up and pay, but the shortage is in AAA, but if Wallace would suddenly

-4-

pays the money to farmers on past contracts -- not future -- that thing could jump to within that figure. The amount that Wallace has paid on all AAA contracts is almost nil and that's where the difference is and I can't tell and nobody else that Wallace may pay the checks tomorrow. I don't think he has spent over 30 or 40 millions. That's where the difference is. Wallace may decide that he will pay that money tomorrow. I think the estimate was around \$500,000,000 on all propositions and he is behind that much in his payments. That is the explanation and I did not want to say it because it brings in Wallace, but we are talking here among ourselves. Does that explain it?

Mr. Gaston: The boys are to get it for themselves and from Wallace's card records and it is not to come from you.

HM, Jr.: My guess is that less than \$50,000,000 has gone out.

I don't know what I have said on the record and what I haven't. You have gotten under my skin a little -- at least you haven't, but Mr. May has. But I think everything I have said up to now is off the record until you get the letter. It is getting down to my integrity and I value that rather highly and I won't let Mr. Mary or anybody else besmirch it.

Q. Would you permit the earmarking of gold in New York for English account for the same purposes as China gold is earmarked?

A. I am sorry, I don't wish to answer that.

Q. Are you ready to tell us anything more about the Chinese?

A. No. But our progress is accelerating. Is that a good word?

Q. Yes.

When we get this letter from Senator Harrison, could we make this background?

A. What do you think, Herbert?

Mr. Gaston: I think it will all be in the letter -- all that is necessary.

-5-

Q. Just some personal touches?

A. That's all right. I feel very keenly about it. I don't mind your using it for background. If anybody could point to any group of figures I have given out since I have been here that have not been on the "up and up", I would like to know about it.

Q. Anything on the international money situation today?

A. No. The situation is still a nervous one.

Q. Is there any particular official reason why there should only be two New York banks very actively in the market?

A. No. That's purely up to them. It is a private commercial transaction and any New York bank can or cannot do it, as they wish.

Q. One in the past has been very closely identified with the activities of the Federal Reserve Bank.

A. It is purely voluntary on their part and they may think they want to invest in gold and bring it over and they may not, but it's purely voluntary. They make their own decisions without any guidance or hints from us.

Q. Is Senator Harrison getting more than one copy of this letter?

A. Yes, he asked me to send up enough copies.

Q. Would you care to say that the British are involved in this Chinese thing?

A. The Chinese Government sent these people over to see the United States Treasury.

Q. The reason I asked is the British have had a financial mission out there for sometime and since the Chinese work pretty closely with the United States and England I thought it reasonable they might be connected here.

A. I again say, the Chinese came over to see the United States Treasury. I hear the Japanese have some interest in

-8-

China, too!

Q. You did not hear that directly from the Japanese who came in to see you, did you?

A. Listen! Go on! No; this is a Chinese-United States situation; just between the two Governments; nobody else is in on it.

oOo-oOo

May 8, 1936

162

My dear Senators:

Senator King requested from the Department estimates of the yield of certain tax proposals, and I assume it is appropriate that I transmit them through the Chairman of the Committee. They are attached.

Very truly yours,

Secretary.

Honorable Pat Harrison,
Chairman, Senate Committee on Finance,
United States Senate

Enclosure

ND 5/8/36

Regraded Unclassified

Estimated increase in revenue from income taxes under Senator King's proposals, as compared with estimated revenue under the Revenue Act of 1935, based on calendar year 1936 incomes.

	: Increase : in : <u>revenue</u> : (in millions : of dollars)
Corporate income tax:	
Rates graduated from 15 percent to 18 percent applicable to the same net income classes as under the Revenue Act of 1935 <u>1/</u>	208
Individual income tax:	
Normal tax rate increased to 6 percent; personal exemptions reduced to \$800 for single returns and \$2,000 for joint returns; surtax rates increased in surtax net income classes below \$62,000 <u>2/</u>	320
Total increase in revenue	<u>528</u>

1/ Corporate tax schedule - upon net incomes not in excess of \$2,000, 15 percent; in excess of \$2,000 and not in excess of \$15,000, 16 percent; in excess of \$15,000 and not in excess of \$40,000, 17 percent; in excess of \$40,000, 18 percent.

2/ Surtax rates begin at 6 percent on surtax net incomes in excess of \$4,000, are graduated more steeply in the surtax net income brackets up to \$62,000 than under the Revenue Act of 1935, and remain the same on surtax net incomes above that amount reaching a maximum rate of 75 percent on surtax net incomes in excess of \$5,000,000.

GA:11
5/6/36

Senator King

My dear Senators:

Senator King requested from the Department estimates of the yield of certain tax proposals, and I assume it is appropriate that I transmit them through the Chairman of the Committee. They are attached.

Very truly yours,

Secretary.

Honorable Pat Harrison,
Chairman, Senate Committee on Finance,
United States Senate

Enclosure

W/O
GMA
EO 128 5/8/36

My dear Senators:

Senator King requested from the Department estimates of the yield of certain tax proposals, and I assume it is appropriate that I transmit them through the Chairman of the Committee. They are attached.

Very truly yours,

Secretary.

Honorable Pat Harrison,
Chairman, Senate Committee on Finance,
United States Senate

Enclosure

EDH 5/8/36

May 8, 1936.

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

Dear Mr. Secretary:

It has been stated that many of our financially strong corporations, especially those of substantial size, will pay little or no taxes to the Federal Treasury if the pending bill is passed. I am checking the accuracy of these statements, and I am likewise interested in the opportunities that may be afforded such corporations by the bill to avoid the payment of taxes.

We must guard carefully against giving these large corporations a greater advantage and perhaps a stranglehold over their present smaller competitors. Frankly, I am concerned about the application of the proposed tax policies to those corporations which now have large surpluses and a strong cash or credit position.

We must make certain that legislation does not prevent the healthy growth and expansion of our smaller businesses by imposing a penalty upon them if their financial position and their business opportunities do not permit the payment in dividends of substantially all their profits. I want your assistance in appraising the situation.

I have selected from Moody's Manual a few of the largest corporations, with a view to determining the rate of tax which would be imposed upon them if the pending bill should be enacted. The only statistics I have available are for 1934. I should appreciate it very much if you would check the list I give you and let me have a similar list for 1935, if statistics are available to you.

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

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

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

CORPORATIONS WHICH WOULD
PAY LESS THAN 5 PER CENT.

Company	Net Income After Tax	Dividends Paid Out.	Tax under New Bill.
Reduction	4,145,416	3,737,142	2.82%
Applied Chemical & Dye Corp.	17,548,355	15,703,374	3.00
Arnold Products Refining Co.	9,702,696	9,294,750	1.20
Artis Publishing Co.	5,906,326	5,400,000	2.45
E. I. duPont	46,701,465	40,788,914	3.50
Dunlop Tire & Rubber	4,154,656	3,572,193	4.00
General Foods	11,143,876	9,452,614	4.40
Great Western Sugar	5,761,727	5,370,000	1.55
Imperial Oil Co.	14,101,561	13,415,169	1.40
J. G. Eggett & Myers Tob. Co.	20,086,691	17,200,227	4.16
W. R. Clarke, Davis & Co.	8,719,368	8,232,480	1.50
Pennsylvania Railroad Co.	13,377,839	13,214,946	.30
W. S. Smelting & Refining	6,052,968	6,000,129	.25

CORPORATIONS WHICH WOULD PAY
LESS THAN 10 PER CENT

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

I also ask that you furnish me with the names of all corporations which, for the last year for which the statistics are available, had a net income, before Federal taxes, of more than \$1,000,000, and, based upon the actual distributions for the year, will receive a tax reduction of fifty per cent or more under the pending bill.

You will appreciate that the fundamental purpose of my inquiry involves not only competitive advantages to the strong corporations, but the restraints of heavy taxes upon small and medium sized enterprises upon which we must depend so largely for re-employment of labor, and for healthy business growth.

It is unnecessary for me to add that the data must be available promptly if it is to serve a useful purpose. I shall appreciate very much your assistance and cooperation.

Cordially yours,

(Signed) HARRY F. BYRD

May 8, 1938

HM, Jr. had the following meeting with him in his office today: Upham, Haas, Bell, Taylor, Gaston and Oliphant.

The Secretary said, "I have two suggestions to make. (1) This fellow May ranks as a No. 1 accountant and has great standing and reputation among business people, and I think it would be a very smart move if we could get someone of equal standing to check the Treasury's estimates and tell us whether we are correct. Haas' reaction was, "It is not an accountant's job. It is not in his field. I could lose him if I wanted to." HM, Jr. then asked him, "Well, who would have?" And Haas replied, "It happens to be my responsibility and I am leaving myself out of it, but as I see the whole thing, they must attack something and they are attacking the estimates. It is a sign of weakness to have somebody come in and recheck our figures. Estimates can't be checked. The thing to do is to sit tight." HM, Jr. inquired of Haas, "So you rely entirely on McLeod?" and Haas answered, "No. We have others who go over his figures." HM, Jr. reminded Haas that the same mistake was made in the President's speech and, he said, "You had two months to find that out, but you didn't."

Turning to Bell, the Secretary said, "You have the background of the Treasury. How would you feel if I brought somebody down? Inasmuch as our figures have been questioned, I want them double checked and analyzed." Bell's reply was, "I do not think it is a sign of weakness to ask somebody from the outside to recheck our figures. The trouble is to get someone who is fair and who afterwards would not go out and seek a lot of publicity." In answer to that, HM, Jr. said, "I have had people in to talk to me from time to time and no one knew that they were down here. On the question of gold devaluation, I had Parker Gilbert down here. He has never told a living soul that I know of."

Continuing, HM, Jr. said, "I don't want to answer May publicly. I will ask the man to come down with the distinct understanding that I may or may not use his figures, but I want him to come down in a confidential capacity, in the same relationship that exists between a doctor and a patient." Haas remarked, "Oh! On that basis, that's different. Then I am in agreement. But I still don't think you ought to get an accountant." Bell remarked that "May is an actuary, an accountant and an economist."

-2-

Speaking to the whole group, HM, Jr. said, "Well, I wish that you would all think about it and bring in some suggestions and meet again at 12 o'clock. I would say that for my own satisfaction, I want to have these figures rechecked; that if we have slipped, I want to say so. I am big enough to say so, if you don't mind my saying so. After reading my statement in the papers this morning, I am perfectly satisfied. It was the clean-cut, manly thing to do."

He said to the group, "The second suggestion that I have to make is that I mentioned the names of Professor Hague of Columbia, to the President and he said 'thumbs down'. My idea was to have this man check what we are doing on the policy of the bill. I am not worried about the bill draft, but I want a fresh mind on the policy." Oliphant said that he did not know Professor Hague.

HM, Jr. again spoke to the group of the suggestion that it might be well to keep the flat rate on corporation income, and in this way assure the collection of a substantial amount of revenue, and then add to that flat tax a graduated or another flat tax on undistributed earnings. The figures suggested were a 15% flat tax and a 15% supertax. He said, "By getting all this revenue from the rich corporations we could possibly reduce the tax for the small man who has an income of \$2500." Oliphant said, "If we change the bill now, we will have no bill," to which HM, Jr. said, "Suppose we do get up against a stone wall. Then what? I, therefore, suggest that we have an alternative bill in our vest pocket."

Haas had the following to say: "Our estimates have been made on the assumption that all this income would be subject to tax. If it leaks through this person you will bring down, then you will not get the revenue." Oliphant said, "I worked on the theory that Haas' estimates were correct. I have every confidence in the basis on which McLeod made his estimates. If any of you know of any loopholes, I wish you would talk about them." Haas added, "If there are any loopholes, I can't take the responsibility." HM, Jr. wanted to know if Oliphant took the responsibility of the loopholes, and Oliphant answered, "Yes, I do." Upham stated, "The people on the Hill are not as confident that the leaks have been filled as Mr. Oliphant is."

HM, Jr. then said to the group, "Well, I think this has

-2-

been a good meeting. First, we are trying to get a man like May to advise the Treasury in a confidential capacity on the mathematical end and, second, we are trying to get an outside person, like Magill, who is not in private practice to get his views on the policy. If I do this, nobody can ever say that the Treasury left a stone unturned to see that this bill will do what we say it will do."

Gaston offered the following suggestion: "What would you think of the suggestion that we send up our estimates on the Hill and say that this is how we arrived at our figures." Haas' reaction was, "I think we first ought to get the accountant, whom you are bringing down, to check our estimates and then if they are sweet, send them up." HM, Jr. thoroughly agreed with Haas.

May 8, 1936

At 12 o'clock today, Oliphant, Upham, Taylor, Gaston, Bell and Haas met with the Secretary.

HM, Jr. said, "Someone has suggested Professor Mills of Columbia. Oliphant said he did not know who he was and Haas said he did not think well of him. The Secretary asked Oliphant to check up on Professor Mills and said, "I understand that Professor Mills has written a book on sources of income and I had him in mind to advise us on the policy of the bill." Oliphant's comment was, "I do not know of anyone better than Viner," but HM, Jr. disagreed, saying "No, not on this thing."

Continuing, the Secretary said, "A Mr. Niven, of Touche, Niven & Co., has been suggested as an accountant and Mr. Staub, of Lynch, Ross and Montgomery." Taylor said, "I would like to suggest the name of Arthur Anderson as the accountant. He is outstanding in every way." Upham thoroughly agreed with Taylor and Mrs. Klotz reminded HM, Jr. that Earle Bailie, in his telephone conversation with the Secretary this morning, had mentioned the name of Anderson. The Secretary immediately put in a long distance call for Arthur Anderson, but was unable to get him before he left the office at one o'clock.

At this meeting, Mr. Taylor suggested an alternate plan and Oliphant asked him to make copies available to the group and they would look into it.

In elaboration of the suggestion which I made at the meeting held in your office on Friday, May 8, 1936, I am listing below certain modifications which might be made in the proposed tax bill:

1. Differentiate between "business income" and income from "investments".
2. Place "business" whether conducted by individual, partnership or corporation on same tax base.
3. Retain principle of graduated rates for business income, based on ability to pay. Give favorable treatment to or exempt "business income" in low brackets.
4. Place "investment income" whether received by individual, partnership or corporation on same tax base, if retained.
5. Tax investment income paid to foreign individuals at flat rate, tax to be withheld at source. Tax investment income paid to foreign corporations at higher flat rate, tax to be withheld at source.
6. Place banks, insurance companies, bona fide investment trusts and other financial institutions which obviously must depend on income from investments in special category when considering income from investments.
7. Exempt investment income from wholly owned subsidiaries operating in the same "business" classification from "investment income" graduated tax but include in "business" earnings of parent company.
8. Possibly place public utility and railroad investment income from controlled but not wholly owned subsidiaries or affiliates in a special category.

As you know, my only purpose in suggesting these modifications is in order to provide some secondary plan if the extant proposals encounter insurmountable difficulties. You will notice that most of the basic principles are retained but their application is altered.

My impression is that the gamble on the amount of revenue is reduced and that we would be dealing with fewer unknown factors.

I particularly direct your attention to the fact that profits from business if retained for reserves must either be invested in tax-exempt securities, or the income from taxable securities must be distributed to stockholders, if high surtax rates are to be avoided. The effect of this provision on personal holding companies and on the investment by business corporations in speculative securities unrelated to their own business is obvious, and means legitimate reserves will be invested in short-term Government's or other tax-exempt securities. This is certainly sound practice, as in the past far too many corporations have dissipated earnings as a result of ill-advised investments in speculative market securities with a consequent loss to the stockholders as well as loss of revenue to the government.

The suggested treatment for foreign individual and corporate holders might well be considered without reference to the other suggestions as it meets in part the problem of personal holding companies incorporated in Canada and elsewhere.

I believe that the differentiations between business income and investment income will stimulate private productive enterprise, and that a slight discrimination in favor of unincorporated individual enterprises is not only justified but a step to be encouraged.

SENATE BACKERS WAYER ON ROOSEVELT TAX PLAN; HARD FIGHT IN PROSPECT

NEW PROPOSALS IN MIND

Connally Maps Tentative Plan, Basing It on Present Law.

DEFENSE BY MORGENTHAU

Possible Ambiguity in Phrasing Does Not Alter Estimate of Yield, He Replies.

ACCOUNTANTS ASSAIL BILL

Through V. H. Stempel They Say Future of Medium-Sized Companies Is Jeopardized.

By TURNER CATLEDGE
Special to THE NEW YORK TIMES.

WASHINGTON, May 7.—A week of constant bombardment by business and industry against President Roosevelt's new tax program apparently was beginning today to have effect upon the Senate Finance Committee, and indications were developing that the administration will have the fight of the year if it holds out for the plan, particularly the proposed new corporate levy based solely on undistributed profits.

Of a total of nearly 100 witnesses who appeared before the committee, only the Treasury spokesmen had thus far supported the proposals as enacted by the House, and committee members who heretofore had been regarded as favorable were either dropping away or beginning to waver, at least to the extent of courting other plans of taxation.

Senator Couzens, independent Republican, who at the start had been counted upon to favor the bill, was reported to have changed his position in light of the testimony of the last three days. Senator Connally, until today a friend of the undistributed corporate profits tax embodied in the House bill, began working in earnest on a plan of his own.

Estimates on Other Plans Sought

The tentative proposal of Senator Connally, who, incidentally, has written more amendments into revenue bills during the last four years than perhaps any other Senator, involved retention of the present corporate income tax and the superimposition of a moderate levy on undisturbed profits along the main lines suggested in an editorial in THE NEW YORK TIMES of May 4.

Senator Connally asked Treasury experts for estimates on the probable additional revenue yield from such a combination, with a flat corporate income tax rate of 12½ per cent and an undistributed profits surtax of 12½ per cent. He explained that this proposal was only tentative, and that he had asked the estimates only as a basis for further perfection of his plan.

"I believe, however," he said, "that we can work out something along this line."

Meanwhile, Senator King asked for estimates on the full plan proposed by THE NEW YORK TIMES, including, first, retention of the corporate income tax at a flat rate of 15 per cent; second, imposition of the full normal and surtax rates on corporate dividends in the hands of stockholders, and, third, an additional levy on undistributed profits, starting at 4 per cent on the first 20 or 25 per cent of corporate income withheld from distribution and a graduated tax of from 5 to 25 per cent on withholdings in excess of that percentage, with specific exemptions from this levy for amounts withheld for plant expansion and replacements.

Senator King also asked for estimates on a plan of his own to reduce the personal exemptions from the individual income tax and in-

crease the rates in the lower and middle brackets, and a higher corporate income levy.

Favor \$620,000,000 More Yield

While all of these developments indicated nothing more than possible future steps, members of the committee felt, generally, that if they could find a tax that would yield the \$620,000,000 in permanent annual new revenue sought by the President the undistributed profits tax might be scrapped as recommended by every representative of business who has appeared at the hearings.

The only qualification to such a prediction was the feeling that if the administration made a determined fight for the President's plan it might win in the long run, particularly since the House has adopted the plan by a majority of nearly three to one.

There was no definite indication, however, as to what the administration's attitude would be in case the program were so modified.

Some Senators said they had it on good authority that if a plan were evolved which would promise the desired additional revenue and at the same time maintain a vestige of the proposed levy on undistributed corporate profits, the President would accept it gladly, rather than hazard a long session and fight with Congress in an election year.

Morgenthau Writes to Harrison

The only representations made to the committee by the Treasury since it completed its testimony last week, or the only answer to any of the attacks, was a letter addressed to Chairman Harrison today by Secretary Morgenthau in which he replied to the assertions made yesterday by George O. May, senior partner of Price, Waterhouse & Co., certified public accountants, that he had uttered a "serious misstatement" in his testimony in support of the House bill.

Mr. Morgenthau had said that "under the present law" \$4,500,000,000 of corporate income would be withheld from stockholders during the calendar year of 1936, with a resultant loss to the government of about \$1,500,000,000. A prerequisite to this figure was the repeal of all existing corporation taxes whereby corporations would not have to pay about \$1,100,000,000 in revenue to the government.

Mr. May said this constituted a "misstatement" because in establishing the figure of \$4,500,000,000, Mr. Morgenthau had not stated that the \$1,100,000,000, or practically one-fourth of the amount, would accrue to the corporations because of repeal of the present corporation tax laws.

In reply, Mr. Morgenthau said there was a "possible ambiguity" in the terms as he used them, but insisted that it did not in any way affect the Treasury's estimate of the probable yield from the new tax.

THE MORGENTHAU LETTER

Secretary Morgenthau's letter to Senator Harrison follows.

"My dear Senator:

"Yesterday, part of the statement which I made before your committee on April 30 was challenged. The particular part of the statement was the following:

"The department has also estimated that under the present law more than \$4,500,000,000 of corporation income in the calendar year 1935 will be withheld from stockholders, and that if this income were fully distributed to the individual owners of the stock represented in these corporations, the resultant yield in additional individual income taxes would be about \$1,500,000,000."

"I can see that the phrase 'withheld from stockholders' was possibly open to misunderstanding inasmuch as the figure \$1,500,000,000 was arrived at after we had deducted from the \$4,500,000,000 an amount equal to the existing corporation taxes.

"What I have just said about a possible ambiguity in the use of this term relates to one of my arguments on the merits of the proposed corporate tax, not at all to my statement of the Treasury's estimate of what this tax would yield. That estimate is \$625,000,000 additional revenue.

"Sincerely yours,

"HENRY MORGENTHAU, JR.,
"Secretary of the Treasury."

Manufacturers Oppose Bill

The business attack against the corporate profits tax was continued today by the National Association of Manufacturers. Noel Sargent, economist, and James A. Emery, general counsel of the Manufacturers Association, repeated substantially the testimony given by the organization's spokesman to the Ways and Means Committee in the initial consideration of the plan, to the effect that it would be crippling to business and of doubtful revenue advantage.

"The measure is not merely a tax proposal," Mr. Sargent said. "It must be considered a regulatory measure and as a form of deliberate national economic planning. It is a further step toward government regulation and regimentation of business."

Mr. Sargent urged that the Finance Committee discard the bill and that a special committee of Congress, the Treasury, business and independent tax economists be set up to study a fundamental revision of the Federal revenue structure.

Mr. Emery said the bill would further complicate the tax system and retard business pioneering, which must proceed if recovery is to come and stay.

Substitute Plan Suggested

A substitute for the pending bill, including a broader income-tax base and a moderate levy on undistributed corporate income, was proposed to the committee by V. H. Stempf of New York in behalf of

the committee on Federal taxation, the American Institute of Accountants.

Mr. Stempf avoided a discussion of any of the social questions involved in the proposed new corporate tax. He confined himself strictly to taxation from an accounting view. In this connection he cited one reason after another for abandoning the pending bill. He filed a memorandum with the committee setting forth in detail the objections of the accountants.

"The committee (the accountants' taxation committee) believes it unwise to jeopardize the future of the great number of medium-sized corporations which are struggling back to sound financial condition by relieving corporations of the

present tax on income to the extent distributed and substituting a new basis of taxation at high rates, which must contain, inevitably, a new field of accounting difficulties and complexities of corporate finance," the memorandum said.

Many details were cited of actual difficulties in computing taxes under the proposed new law. It was "quite evident from an examination of the provisions of the proposed law that simplification has not been attained or even approached."

Would Retain Present Policy

The recommendations presented by Mr. Stempf included:

Retention of the present corporate income tax at higher rates if necessary.

A reduction in personal exemptions to the personal income tax in order to broaden the base, or the same result be obtained by an irrecoverable withholding at source in respect of fixed or determinable income of the character required to be included in information returns under the existing law.

Increase in the normal income tax rate and its application to corporate dividend if necessary.

Application of the principle of the undistributed corporate profits tax, but at a low rate on a fixed base by subjecting to this form of surtax the excess of "adjusted net income" over, first, the corporate income tax on such income and, second, dividends paid during the taxable year.

As an alternative of the undistributed profits tax, and as an incentive to increased dividends, Mr. Stempf proposed the following:

"In conjunction with a higher corporate income tax rate (applied directly to the fixed or determinable base of 'adjusted net income' as heretofore) a 'drawback' at fixed rate (applied directly to the amount of dividends paid during the taxable year) may be allowed as a credit against the corporate income tax.

"This basis also avoids the mathematical complications of a variable rate on a variable base. It would

seem logical that the larger the rate of 'drawback' the greater would be the incentive to increased distribution of dividends (within the limits of sound financial practice) resulting in a greater yield from the surplus on individual incomes."

Opposes Non-Residential Levy

Paul F. Cohen of Niagara Falls, He filed a memorandum with the committee setting forth in detail the objections of the accountants.

"The committee (the accountants' taxation committee) believes it unwise to jeopardize the future of the great number of medium-sized corporations which are struggling back to sound financial condition by relieving corporations of the

present tax on income to the extent distributed and substituting a new basis of taxation at high rates, which must contain, inevitably, a new field of accounting difficulties and complexities of corporate finance," the memorandum said.

Many details were cited of actual difficulties in computing taxes under the proposed new law. It was "quite evident from an examination of the provisions of the proposed law that simplification has not been attained or even approached."

The recommendations presented by Mr. Stempf included:

Retention of the present corporate income tax at higher rates if necessary.

A reduction in personal exemptions to the personal income tax in order to broaden the base, or the same result be obtained by an irrecoverable withholding at source in respect of fixed or determinable income of the character required to be included in information returns under the existing law.

Increase in the normal income tax rate and its application to corporate dividend if necessary.

Application of the principle of the undistributed corporate profits tax, but at a low rate on a fixed base by subjecting to this form of surtax the excess of "adjusted net income" over, first, the corporate income tax on such income and, second, dividends paid during the taxable year.

Calls Bill Too Complicated

Appearing as one of the Manufacturers Association witnesses, Will H. Mooney of Cincinnati, president of the American Oak Leather Company, said the pending bill was so complicated and contained so many provisions of doubtful constitutionality "that it contradicts the primary reasons for its advocacy."

J. R. Glass of New York, economist of the Tanners Council of America, said the bill would damage if not destroy many corporations in the tanning industry because of the fluctuations in inventory values due to prices. A company, he said, might frequently have a paper profit on its books but a variable base of inventory value which

could not be shown or paid in cash, although this profit would be subject to the full weight of the levy on undistributed earnings.

A special plea on behalf of the mining industry for abandonment of the proposed profits tax was made by Julian D. Conover of Washington, secretary of the American Mining Congress; A. G. MacKenzie of Salt Lake City, representing the State Association of Metal Mine Operators and Donald A. Callahan of Wallace, Idaho, representing the Idaho Mining Association. They argued, in effect, that the hazards and fluctuations of the mining business would render them special victims of such a tax.

M. E. Peloubet, member of the firm of Pogson, Peloubet & Co., certified public accountants of New York, also representing the American Mining Congress, suggested an administrative amendment relating to inventories which, he said, would make it possible for taxpayers to report as taxable income the income which is "realizable," rather than the income which is the result of arbitrarily writing up or writing down assets.

For Life Insurance Amendment

Lawrence A. Baker, general counsel for the National Association of Life Underwriters, asked the committee to amend the bill to exempt the proceeds of life insurance policies applicable to the payment

of estate, inheritance and other death dues. Senator Lonergan of Connecticut, member of the committee, subsequently announced that he would sponsor such an amendment.

L. W. Talliaferro of Detroit, representing the Hammond Standish Company, continued the plea of independent backers for relief from the "windfall" levy to recoup formerly impounded or unpaid processing taxes.

H. W. Storey of Milwaukee, representing the Allis-Chalmers Manufacturer, asking that revisions be made to protect national mortgage associations, set up under the factoring Company, made a frontal attack on the whole bill. He said it created more inequities than in existing law, and further that it fixed a dividend policy for a corporation without any regard for its needs. He related that his own company had re-employed 1,800 men since Jan. 1, but that if it could not keep sufficient of its earnings for reserves it could not employ more or keep those now on the payrolls at work.

A brief filed with the committee by C. H. Mylander of the American Bankers Association urged revision of the bill to continue the present exemptions of dividends paid on bank stock from the normal income tax rate. He urged that the other special treatment of banks as carried in the House bill be retained.

Anti-Tax Bill Democrats May Force Revision

Corporation Levy Proposal
May Be Discarded; Surtax
Planned as Substitute

Morganthau Reply to May

Admits Possible Ambiguity
in Statement on Revenues

From the Herald Tribune Bureau
WASHINGTON, May 5.—A major revision of the Administration program to levy an undistributed income tax on corporations appeared to be approaching realization today, when there were very definite indications that a bloc of Democrats of the Senate Finance Committee were in revolt against the House tax bill and were discussing a variety of substitute plans.

These democratic members of the committee, including principally those labeled "conservative," were frank to say that a week of solid business opposition to the House bill was having its effect. While they declined to publicly go on record until after executive sessions, sentiment has been crystallized for tempering the revolutionary tax plan, either by imposition of an undistributed corporate income tax only as an experimental surtax or by scrapping the new proposal and resorting to increases in present corporation taxes to obtain additional revenue.

Morganthau Answers May

Talk of extensive changes in the tax bill came as Henry Morganthau Jr., Secretary of the Treasury, in a letter to Senator Pat Harrison, Democrat, of Mississippi, chairman of the committee, admitted that a statement which he made before the Senate committee may have included an ambiguity. Mr. Morganthau was answering a charge by George O. May, nationally known statistician, that the Secretary of the Treasury had been guilty of an "obvious and serious misstatement of fact."

While reporters had been given the impression that the Secretary of the Treasury would make comprehensive answer to Mr. May's contention that the pending tax bill would not increase the revenue that might be expected under existing law, Mr. Morganthau's letter simply reiterated that the Treasury estimate was that \$623,000,000 of additional revenue would be obtained under the proposed new law.

Letter to Harrison

The Secretary of the Treasury wrote to Senator Harrison as follows:
"Yesterday part of the statement which I made before your committee on April 30 was challenged. The particular part of the statement was the following: 'The department has also estimated that under the present law more than four and one-half billion dollars of corporation income in the calendar year 1926 will be

withheld from stockholders, and that if this income were fully distributed to the individual owners of the stock represented by these corporations, the resultant yield in additional individual income taxes would be about one and one-half billion three hundred millions.

"I can see that the phrase 'withheld from stockholders' was possibly open to some misunderstanding, inasmuch as the figure \$1,300,000,000 was arrived at

Day in Congress

From the Herald Tribune Bureau
WASHINGTON, May 7.—The activities in Congress today were:

SENATE

Met at noon.
Adopted conference report on the Army appropriation bill.
Adopted conference report on the appropriation bill for state, justice, commerce and labor departments.
Debated the Navy appropriation bill.

Recessed at 4:10 until noon tomorrow.

HOUSE

Met at 11:30 a. m.
Began debate on the relief appropriation bill.
Adjourned at 5:30 until 11 a. m. tomorrow.

after we had deducted from the \$1,300,000,000, an amount equal to the existing corporation taxes.

"What I have just said about a possible ambiguity in the use of this term relates to one of my arguments on the merits of the proposed corporate tax, not at all to my statement of the Treasury's estimate of what this tax would yield. That estimate is \$623,000,000 additional revenue."

Mr. May "caught up" the secretary's statement before the Senate committee by pointing out that Commissioner of Internal Revenue Guy T. Halvering had said that the distribution of \$1,300,000,000 was conditional on repeal of existing corporation taxes. Treasury officials in discussing Mr. Morganthau's letter explained that the \$1,300,000,000 of additional income taxes was figured by the Secretary on the basis of a corporate distribution of approximately \$5,000,000,000. It was admitted, however, that Mr. Morganthau's statement could be read to imply that the additional revenue had been computed on the basis of \$4,500,000,000, or without deduction of existing taxes. This had been the point raised by Mr. May.

Although Senate committee members were not quite ready to discuss revisions of the bill indicated, Senator David I. Walsh, Democrat, of Massachusetts said: "After listening to the testimony, it is my personal opinion that the bill will have to be extensively and materially redrafted. I think a good many of my colleagues on the committee feel the same way."

Senator Tom Connally, Democrat, of Texas, a staunch Administration supporter, was pressing for approval of the undistributed corporate income tax as a surtax. The Senator announced that, under his preliminary plan, corporations would be subjected to a flat 12 1/2 per cent tax on net income, the type of taxation of existing law. The concern would also be subjected to a 12 1/2 per cent tax on their undistributed income. This would amount to a 12 1/2 per cent tax on income that is distributed and a 25 per cent tax on income retained.

King in Offer Two Plans

There are other plans under discussion. Senator William H. King, Democrat, of Utah, will present two new income taxes, and the other two to adapt an undistributed income tax as a low-rate experimental tax. Another proposal before the committee is to decrease the value of the House bill running up to 48 1/2 per cent by substituting a scale running downward from 25 to 15 per cent of total net income, with the lower rates obtained if income is distributed. Senator Harrison is also working on a revision of the House bill, with the purpose of simplification. It was reported that he was disturbed by the rising insurgency of his colleagues.

Opposition to the bill intensified today with a comprehensive attack by the National Association of Manufacturers. Noel Sargent, economist, of the association, and James A. Emery, general counsel, attack the "deliberate economic planning" and the "regimentation" of the new proposal. They protested its complicated character, its increase of tax inequities and its uncertainty as to revenue proceeds.

Gets Bankers' Views

The Senate committee today received the first statement of the American Banking Association on the pending tax bill. The A. B. A. declared in favor of the 15 per cent preferential tax rate which the bill gives to banks, but asked that the bill be revised to exempt bank dividends from the normal individual tax of 4 per cent.

The A. B. A. pointed out that the country's banks owe the government \$770,000,000, and that this sum could be paid only through accumulated earnings or through sale of stock to residents of the community in which the bank operate. Because of the low earnings of banks sale of bank stock was difficult, the A. B. A. said. Everything should be done, the bankers declared, to make bank stocks attractive in order that the government might be repaid for its stock. The conclusion was that initial imposition of the normal income tax on bank dividends would be undesirable.

The Bankers' Association also protested the severe tax rates of the holding company provision of the pending bill, pointing out that there were bank holding companies having deposits of \$2,000,000,000. These holding companies are required to retain a certain amount of net income under existing Federal regulation. It was pointed out, and the A. B. A. requested that the income of bank holding companies, required to be withheld by law, be considered as distributed income. The Federal Housing Administration also made a somewhat similar request with regard to national mortgage associations.

UNITED STATES SENATE
Committee on Finance

May eighth,
1936.

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

My dear Mr. Secretary:

It has been stated that many of our financially strong corporations, especially those of substantial size, will pay little or no taxes to the Federal Treasury if the pending bill is passed. I am checking the accuracy of these statements, and I am likewise interested in the opportunities that may be afforded such corporations by the bill to avoid the payment of taxes.

We must guard carefully against giving these large corporations a greater advantage and perhaps a stranglehold over their present smaller competitors. Frankly, I am concerned about the application of the proposed tax policies to those corporations which now have large surpluses and a strong cash or credit position.

We must make certain that legislation does not prevent the healthy growth and expansion of our smaller businesses by imposing a penalty upon them if their financial position and their business opportunities do not permit the payment in dividends of substantially all their profits. I want your assistance in appraising the situation.

I have selected from Moody's Manual a few of the largest corporations, with a view to determining the rate of tax which would be imposed upon them if the pending tax bill should be enacted. The only statistics I have available are for 1934. I should appreciate it very much if you would check the list I give you and let me have a similar list for 1935, if statistics are available to you.

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

Company	Net Income After Tax	Dividends Paid Out.
American Tel. & Tel.	\$121,748,723	\$187,980,475
American Tobacco Co.	24,004,260	26,590,858
Amer. Smelting & Refining	7,585,202	7,875,000
General Electric Co.	19,722,044	19,821,453
Goodyear Tire & Rubber Co.	4,227,684	4,508,907
International Harvester	3,942,637	6,264,040
Natl. Biscuit Co.	11,597,575	13,939,342
Natl. Dairy Products Co.	8,551,930	6,197,575
Ohio Oil Co.	5,411,924	6,294,728
R. J. Reynolds Tobacco Co.	21,536,894	30,000,000
Texas Company	5,645,205	9,346,620

- 2 -

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

CORPORATIONS WHICH WOULD
PAY LESS THAN 5 PER CENT.

			Tax Under New Bill.
Air Reduction	4,148,418	3,737,142	2.82%
Allied Chemical & Dye Corp.	17,548,355	15,708,374	3.00
Corn Products Refining Co.	9,702,896	9,294,730	1.80
Curtis Publishing Co.	5,806,326	5,400,000	2.80
E. I. du Pont	40,701,468	40,739,974	5.60
Firestone Tire & Rubber	4,154,656	3,572,135	4.00
General Foods	11,143,876	9,432,614	4.60
Great Western Sugar	5,781,727	5,370,000	1.55
Imperial Oil Co.	14,101,561	13,415,169	1.40
Liggett & Myers Tob. Co.	20,036,091	17,200,227	4.16
Parke, Davis & Co.	3,719,368	3,232,480	1.50
Pennsylvania Railroad Co.	13,577,833	13,214,843	.30
U. S. Smelting & Refining	6,082,933	6,000,129	.25

CORPORATIONS WHICH WOULD PAY
LESS THAN 10 PER CENT

Company	Net Income After Tax	Dividends Paid Out	Tax Percentage Applicable
American Can Co.	\$19,522,045	\$15,256,321	5.84
Armour and Co. (Del.)	8,235,835	5,899,630	6.54
Eastman Kodak Co.	14,505,247	10,499,085	5.73
General Motors	94,739,151	73,621,710	5.72
Great A. & P. Tea Co.	20,479,130	16,430,736	7.79
International Shoe Co.	9,967,034	6,671,742	9.37
J. C. Fazy Company	16,147,315	11,307,108	6.30
Phillips Petroleum Co.	5,757,309	4,153,008	6.30
Proctor & Gamble	14,370,067	10,512,306	6.00
Secor-Vacuum Oil Co.	24,121,207	19,682,561	6.06
Standard Oil Co. (Calif.)	19,347,307	13,000,479	5.60
Standard Oil Co. (Ind.)	18,340,690	15,371,229	5.08
Standard Oil Co. (N.J.)	67,822,271	54,304,103	5.22
Texas Gulf Sulphur Co.	6,822,476	5,730,000	6.30
United Fruit Co.	12,049,300	9,717,905	6.34
F. W. Woolworth Co.	32,142,563	23,236,676	

I also ask that you furnish me with the names of all corporations which, for the last year for which the statistics are available, had a net income, before Federal taxes, of more than \$1,000,000, and, based upon the actual distributions for the year, will receive a tax reduction of fifty per cent or more under the pending bill.

You will appreciate that the fundamental purpose of my inquiry involves not only competitive advantages to the strong corporations, but the restraints of heavy taxes upon small and medium sized enterprises upon which we must depend so largely for re-employment of labor, and for healthy business growth.

It is unnecessary for me to add that the data must be available promptly if it is to serve a useful purpose. I shall appreciate very much your assistance and cooperation.

Cordially yours,

(Signed) Harry F. Byrd

FEDERAL RESERVE BANK
OF NEW YORK

181

OFFICE CORRESPONDENCE

DATE: May 8, 1939.

TO: CONFIDENTIAL FILMS

SUBJECT: TELEPHONE CONVERSATION

FROM: L. W. Knake

WITH BANK OF ENGLAND.

I called Mr. Bolton at 12112 P. M. today. He reported that the day had not been quite as bad as yesterday, when there had practically been a panic; the Bourse was a trifle quieter but the export of capital was proceeding at much the same pace. There had been a very distinct weakening this afternoon of the position of the Dutch and the Swiss currencies, probably because everybody seemed to expect that something would happen in France over the weekend. Personally, he did not share that opinion. Weakness of the guilder, he thought, could in part at least be blamed upon the slow mechanism of the Netherlands Bank when it came to deliver gold; also upon the fact that the Dutch bank closes at 5 o'clock and nothing in the world will induce it thereafter to do anything until the following morning. Meanwhile the pressure on the franc continued and the question was how long the French could hold out.

I referred to the rumor circulated here that future dealings in foreign exchange had been suspended on the Paris Bourse. Bolton said that although he had heard of it he did not believe it to be true. What had probably happened in Paris was that, owing to the scarcity of cash, the speculators had found it difficult to scrape the necessary cash margin together and were consequently compelled to reduce the volume of their operations.

I asked him whether the much talked of squeeze of the shorts seemed as imminent as some of the reports indicated. Bolton thought that there was undoubtedly an enormous amount of speculation going on, especially in Amsterdam and Paris, but did not believe that the demand for francs from this source, once the gamblers were compelled to run for

OFFICE CORRESPONDENCE

DATE May 8, 1936.

TO CONFIDENTIAL FILES

SUBJECT: TELEPHONE CONVERSATION

FROM L. W. Knoke

WITH BANK OF ENGLAND.

- 2 -

cover, would be strong enough to reestablish public confidence. As he put it, confidence would have to come first. Needless to say, they would like nothing better than to see a few of the speculators run.

I inquired as to the size of his operations today and Bolton replied that they had been about the same as usual. (We have since learned that they are estimated to have been in the neighborhood of 250,000,000 francs.) Engagements for New York, he estimated at about \$10,000,000. (Total reported to us by New York banks is \$10,395,000.) The demand for gold in London, Bolton said, continued to be tremendous, both sovereigns and eagles being quoted at quite a premium. The London price for gold bars had risen from 140 shillings and 5 pence halfpenny at the fixing to 140 shillings and 7 pence late in the afternoon. The latter figure works out about \$35 per ounce delivery in London.

Everybody, Bolton thought, had the jitters this weekend.

LWK:KMC

May 8, 1936 .

This was prepared by the Secretary, but it was not necessary to give it to the President.

DRAFT

During a discussion on Housing yesterday, you casually mentioned the fact that you were having difficulty in bringing CCC camps to the full enrollment. You further dropped the remark that you might have to go outside of the relief families for future candidates for the CCC camps and might take boys from families whose income did not exceed \$500 a year.

It seems to me if this principle were applied to the CCC boys, it would not be very long before we would be giving work to families from the same class and the chances of our reducing the annual expenditures for unemployment would go out the window.

I believe I am right in saying that the reason you are having difficulty in getting more CCC boys is because they are finding employment and that is, of course, what we want. If we extend this opportunity to boys coming from families who have some income, I just cannot see any end to the road of deficits.

Up to now, I have been entirely satisfied with the fiscal picture and I can see a balanced budget coming before we will have to resort to the printing press, but once we begin to use Federal funds for families who are not in need I really

-2-

would become alarmed over the future of the fiscal foundation of your Administration.

May 8, 1936

I called the President at 9:15 this morning.

I told him that Cochran, in our telephone conversation this morning, had said that the market in Paris was very nervous; that Parker Willis had sent a cable over that we had entered into an agreement with England on stabilization; that Cochran had asked what he should answer them and I facetiously said, "Say that he is just another professor."

The President suggested putting someone on Parker Willis' statements with the idea that someone ought to make a radio talk -- not he, the President, nor I -- and talk about misinformation by some Americans, disloyalty of some Americans, to their own Government; that one American sends information to Paris who just in a short space of a year has made so many false statements that he has seriously hurt the position of the country. "I think it would be interesting to do this," the President said.

I then told the President that I had asked the men in the Treasury to set up all of Parker Willis' statements to date. They will put these on one page and on another page prepare another statement showing how incorrect his statements have been.

I also had the following to tell the President: I saw Pat Harrison and he is going to want to see you and wants to change the whole bill. Before he sees you, however, I think the Treasury boys and I ought to have a 'dress rehearsal' with you. I said to Pat, 'I have not talked to the President about the bill since you and I talked together and I do not want to change my position before you and I see the President again.' I told him that because I was afraid that if I talked too much about it, he might quote me. I also told the President of Pat Harrison's suggestion that in addition to the present flat rate on corporate income, there be an added flat tax on undistributed earnings. The figures Pat used were a 15% flat tax and a 15% supertax unless more than 30% of the corporation earnings were withheld, in which case he would recommend a graduated supertax on the withheld earnings.

I also said to the President, Pat Harrison also told me that Gifford, of A.T. & T., had said that if this bill went through, he would pay no tax as against paying \$30,000,000 now. Pat's suggestion would make him pay something. I am

-2-

thinking of bringing down a national accountant, I told the President, to analyze our figures in order to answer May. I asked him, "Do you know Hague of Columbia? Do you think well of him?" and the President replied, "No; I do not think well of him. I put him on the original St. Lawrence Investigatory Board. He brought in a very wishy-washy report and I finally had to swing over the way way. He did not stand up."

Friday
May 8, 1936

186A

HMjr: Strange as it may seem I'm in a very good humor.
Earle
Baillie: Good!

HMjr: Because I think that I made a straight-forward answer to Mr. May where everybody sort of wanted me to kind of duck it.

B: I think you were a hundred percent right.

HMjr: And, I gave - I mean I made a perfectly honest answer. Well, didn't you feel that way?

B: Yes, I felt exactly that way. In fact I said exactly that thing at the table this morning when I was reading it.

HMjr: And I think that if we do make a mistake that the people have far more confidence in the Treasury if we say so.

B: Absolutely!

HMjr: Yes

B: I mean there's no patent on perfection any place.

HMjr: No

B: Even Mr. May's article I think in one or two places was --

HMjr: Oh, yes, now - that leads me up to what I want to ask you in confidence - I thought that I might want to bring down whoever the head of Ernst & Ernst is and let them look at our figures and then tell us whether our bases for our estimates are right or wrong. What would you think of that?

B: Well now, I don't know about that firm.

HMjr: Yes

B: Let me tell you, I mean I don't know about their recent standing.

HMjr: Yes

B: I do know that in the pre-depression day -

HMjr: Yes

B: - in 1928 and 29 they were connected with a couple of rather phony situations and got criticized for it. What their standing now is, it must

HMjr: Yes

B: In other words if you're going to do this you want to do this with somebody who's - who is -

HMjr: The top of the heap.

B: Exactly. Well now, they aren't.

HMjr: Well, who is?

B: Well now, of course Mr. May is.

HMjr: I know, but I -

B: But I mean - I mean I'll just start with that.

HMjr: Yes

B: He is without any doubt recognized every place as the top man.

HMjr: Yes

B: Now there are four or five others, Rexford first -

HMjr: Yes

B: The trouble is that most of them have rather an English flavor to them. In other words, take for instance the people who do the - have done the work for us in the companies for so long - the Lloyd Printer Gibbons and Company -

HMjr: Yes

B: They have an excellent reputation.

HMjr: Yes

B: And yet there is nobody in that group, broad-gauge man -

HMjr: Yes

B: - who could possibly stand up against the type of man that May is.

HMjr: Yes

B: Now Arthur Andersen and Company are another excellent firm. But I don't know --

HMjr: Well, Earle, may I ask this? Has Ernst and Ernst possibly gone through a reorganization in the last two or three years?

B: Well now that's - that I can find out. That's what I'll make my business to find out right away.

HMjr: And is - possibly they've got a new president.

B: It may well be - that may well be - that - I've really put them out of my mind seven years ago and haven't looked at them since just because of the - of the criticism at that time which was well founded.

HMjr: Well --

B: On the other hand, you know, even the great firm of Price Water House -

HMjr: Yes

B: - advised on the Lord Kilphan balance sheet -

HMjr: On the what?

B: On the Lord Kilphan balance sheet in England. And the Parker of Price Water House was indicted and tried over there.

HMjr: Who did they advise?

B: Lord Kilphan, who was the shipping man who was sent to jail.

HMjr: I know, Lord Kilphan?

B: Yes

HMjr: And it was Price Water House advised them?

B: The English Office of Price Water House advised them.

HMjr: Yes

B: I just point that out so as to show you that even God has specks on him You get my point?

HMjr: Yes, but this fellow isn't God.

- B: (Laughter) No, but he sometimes thinks he is. It's rather his --
- HMjr: Yes, as a matter of fact, I could pull some of his testimony apart.
- B: Well, I thought you could too.
- HMjr: But that --
- B: But I don't think it's productive.
- HMjr: It isn't up to me.
- B: Yes, I quite agree with you.
- HMjr: Now listen, Earle, if you've got a half an hour would you mind phoning around - ?
- B: I'll get right to work on it and I'll spend the rest of the morning on it.
- HMjr: And then will you call me back?
- B: Yes, I'll - what I'll try to find out is first about Ernst and Ernst -
- HMjr: Yes
- B: Second, I'll see if - if I don't get a good answer there I will try to see if there isn't some outstanding accountant in one of the big firms whom I could heartily recommend to you as an independent person.
- HMjr: That's right.
- B: Now, I'll go right at it.
- HMjr: Now, there is an advantage of having a firm that is nationally know.
- B: Exactly.
- HMjr: Now, the firms that you mentioned mean nothing to me. I never heard of them. Now that -
- B: Yes, I get you. Well, - Lybrand Ross and Montgomery is another nationally known firm.
- HMjr: Yes - You see, to me Price Water House and Ernst and Ernst - I've heard those names over and over again.
- B: Yes - well, now at the present time - I don't hear. I mean, they don't convey that to me. But -

HMjr: No, but I'm the 'man on the street', you see?

B: I get you.

HMjr: And I suppose - and now I don't want to - you, you, if you would, go to work on it and call me back?

B: I've got your problem, Henry, and I'll go right at it.

HMjr: Because, here's the way I feel, as problem number one, - Are our estimates of revenue correct?

B: Right

HMjr: If we can satisfy ourselves as to that that's fifty percent of the question.

B: Right

HMjr: Isn't that right?

B: Yes, I think it is.

HMjr: That's fifty percent. The other - other problem, see -? which I may talk to you later over the week-end.

B: Right

HMjr: But if you could do this for me?

B: Well, I've got - I've got some further ideas on that and I'd like to talk on the telephone with you over the week-end about it.

HMjr: I will.

B: Where are you going to be, Hen?

HMjr: Right here.

B: Righto

HMjr: Right

B: All right, you'll hear from me in an hour or two.

HMjr: Thank you.

B: Goodbye.

Friday
May 8, 1936

HMjr: Hello
Earle
Baillie: Hello, Henry

HMjr: Hello, Earle

B: Henry, I've got the following things to suggest.

HMjr: Please

B: In the first place I'd like to make a very radical suggestion which I think would be excellent policy and a good thing to do.

HMjr: Yes

B: It's not an exclusive suggestion, it's part of a general suggestion so hear me through before you express a view.

HMjr: That's all right.

B: I would send for George May -

HMjr: Yes

B: and I would ask him to come and sit down with me. I'd say to him that you-each of you had only one thing at heart you felt sure and that was the soundness of whatever measure went through and you wanted him to look at your figures and see - point out to you personally where they were wrong if they were wrong.

HMjr: Yes

B: You want to know what the facts were. I think, from the point of view of getting advice you'd be talking to the best man in the country; from the point of view of spiking the enemies' gun, you'd make it almost impossible for him to be an effective weapon from that time on against you.

HMjr: I see.

B: Now, that's a low point of view -

HMjr: Yes

B: But I see it combines several rather attractive features.

HMjr: Yes

B: Now then, I wouldn't see him alone. I would ask down one of the two following persons, Mr. Niven, of Touche Niven -

HMjr: Mr. who?

B: N-i-v-e-n

HMjr: N-i - ?

B: v-e-n

HMjr: Niven?

B: Niven of Touche Niven

HMjr: of Touche

B: Niven

HMjr: Touche Niven, yes

B: Now then, I don't know him personally, but two men whom I - of whom I have the highest regard and who work with accountants constantly, tell me that of the accountants -

HMjr: Yes

B: - in this country, that second to May -

HMjr: Yes

B: - he's the kind of a fellow who stands on his own feet, who would not be overwhelmed by May at all.

HMjr: Yes

B: I mean, if he thought he was right the devil couldn't keep him from saying so.

HMjr: Yes

B: Now if you couldn't get him or if he couldn't for some reason or other sit in - of course I don't know anything about politics or --

HMjr: No, I don't - I don't care.

B: Well, neither did I. I knew you didn't, but I mean I did want to say that. I haven't had time --

HMjr: Yes - is Mr. Niven the head of the firm?

B: Well, I think Mr. Touche has died.
HMjr: Yes
B: Mr. Niven is the active leading man.
HMjr: Yes
B: Now there's - the other man is a fellow named Staub,
S-t-a-u-b.
HMjr: Yes
B: Of Lybrand, Ross and Montgomery
HMjr: Of what?
B: Lybrand -
HMjr: Library?
B: L-y-b-r-a-n-d
HMjr: Lybrand?
B: Lybrand, Ross and Montgomery
HMjr: Ross?
B: Yes
HMjr: Yes
B: and Montgomery.
HMjr: Yes
B: Now, both Touche Niven and Lybrand, Ross and Montgomery
are A-1, very prominent firms.
HMjr: Yes
B: Their names, to anybody who is a student of that school
at all would stand just aces high.
HMjr: Yes
B: So either one of those fellows would be useful but it's
only fair to say that I couldn't find anybody who said
that George May had any second in his field.
HMjr: Any which?

B: Any second -

HMjr: Second?

B: In other words George May is the first man in his field and he is the second man in his field according to the public opinion.

HMjr: Yes

B: Now this - here is the other suggestion that I have to make. There is a man named Frederic Mills, M-i- double l-s, professor at Columbia -

HMjr: Yes

B: - who has published over a period of the last three or four years -

HMjr: Yes

B: - studies on the sources of income in the United States, from various points of view including the tax point of view, -

HMjr: Yes

B: - which are the best things of their kind that have ever been written.

HMjr: I see.

B: And he probably knows more about the sources of the income in this country -

HMjr: Yes

B: than any other single individual.

HMjr: I see.

B: And I think that that fellow -

HMjr: Yes

B: I don't know whether you could get him or not -

HMjr: Yes

B: But if you could get him - and he told me that a set of figures were right -

HMjr: Yes

B: - from the business point of view, because after all that's - you're just as much interested in that -

HMjr: That's right.

B: I would believe him.

HMjr: Yes

B: I'd absolutely believe him.

HMjr: Yes

B: Now that's about the story, Henry.

HMjr: Well that's very very helpful.

B: I think my, - don't dismiss my May suggestion lightly.

HMjr: Pardon me?

B: I say, don't dismiss my --

HMjr: I - I don't want to sound Rooseveltian, but I did have it in mind.

B: (Laughter) O. K.

HMjr: All right

B: All right, sir

HMjr: All right

B: I know that man well enough to know, -

HMjr: Yes

B: - that he'd never take advantage of you.

HMjr: Yes

B: I mean, he's that kind of a fellow.

HMjr: Well, that's nice, but I take advantage of so easy.

B: I think you could take advantage of him.

HMjr: (Laughter)

B: Right

HMjr: All right

B: All right, I'll be hearing from you over the weekend.

HMjr: Yes, that's right.

B: Goodbye.

HMjr: Goodbye.

* * * *

HMjr: Get me the University of Chicago.

Operator: All right.

Friday
May 8, 1936

187

Operator: Here you are -

HMjr: Hello -
H. M.
Cochran: Hello - hello, Mr. Morgenthau -

HMjr: Good morning - hello, Cochran -

C: Mr. Morgenthau?

HMjr: Yes

C: Do you hear me?

HMjr: I hear you.

C: You can hear me?

HMjr: Yes

C: The market is a little nervous today -

HMjr: Yes

C: The turnover is not nearly so large as yesterday.

HMjr: Yes

C: At two forty-five this afternoon Guaranty had done three and one half million dollars.

HMjr: Yes

C: The Control is in at seventy-five point sixty-two having - with a little more business done over London -

HMjr: Yes

C: for New York.

HMjr: Yes

C: But still today it's not nearly so nervous as yesterday.

HMjr: Yes

C: The market seems rather bare of francs.

HMjr: Bare of francs?

C: That's right. And the big French banks have stepped out of the forward markets.

HMjr: Yes

C: So that's the situation a little bit.

HMjr: Well now, would you say that there was - that it's better or worse?

C: It looks better today.

HMjr: Better today?

C: Yes

HMjr: Better today?

C: Beg pardon?

HMjr: Is the situation better or worse today?

C: It's better today.

HMjr: Better today?

C: Yes - The stock market opened rather badly with the Bank of France shares down and the down.

HMjr: Yes

C: Improving since the opening -

HMjr: I see.

C: The situation is not good yet.

HMjr: Yes

C: But still it is better than yesterday.

HMjr: Yes

C: Considerably better.

HMjr: All right, now your cables are very helpful.

C: I departed that visit yesterday morning.

HMjr: Yes

C: I was out there at eight-thirty.

HMjr: Is that right? - Now, Cochran -

C: Yes

HMjr: You needn't send any more cables across the Channel.

C: No?

HMjr: No - you can stop that.

C: Beg pardon?

HMjr: Stop sending any more copies of your cable across the Channel.

C: I see.

HMjr: Do you know what I mean?

C: Yes

HMjr: I mean I make it specific, you needn't send anymore to Butterworth.

C: Beg pardon?

HMjr: You needn't send copies of your cables to Butterworth.

C: I understand.

HMjr: You haven't gotten any more from him, have you?

C: No, I haven't for a while.

HMjr: No, well then you stop sending him cables.

C: I see.

HMjr: Yes

C: And - did you hear about the Parker Willis article in the "Agence Economique" this morning?

HMjr: No

C: I wired it to you in its entirety.

HMjr: What does - what does my friend Parker say this morning?

C: He said that it was generally admitted that an important agreement had been concluded between the British and American authorities - which is due to the present relation of dollar and pound.

HMjr: Wait a minute, say it again.

C: Really due -

HMjr: I say, start from the beginning.

C: Yes - I'll read it verbatim.

HMjr: Is it very long?

C: No -

HMjr: All right

C: - 'It is generally admitted that an important agreement has been concluded between British and American authorities which is due to maintaining the present ratio of dollar and pound in face of monetary dangers in Europe.'

HMjr: Yes

C: 'When Mr. Morgenthau as to whether its ratio would permit that any stabilization bond could forego in New York against the dollar sale or eventual export, declared that he did not wish to discuss it. This answer has been interpreted as confirming actual conclusion of an Anglo-American Agreement. According to other information straight from unofficial sources the agreement has already entered into effect.'

HMjr: Yes

C: 'It appeared that the rate for conversion of pound into dollar of about the present level with allowances made for the ratio periodically within the limit of terms outlined by British monetary authority.'

HMjr: Yes

C: 'The of the American authorities has been attributed by this act as its arrangement conclusion of a stabilization agreement with Great Britain. And yet only a few months ago the creation of such a state of affairs was declared improbable by both parties.'

HMjr: Yes

C: Treasury some irritation high officials of the at the Treasury in the matter of monetary policy operates on a twenty-four hour basis.

I think this has attracted quite a bit of attention over here.

HMjr: What's that?

C: This has attracted considerable attention.

HMjr: Well, your comment can be that he's just another professor.

C: (Laughter) Well, I won't make any, but I want you to have the full text -

HMjr: All right - just another professor

C: I see our friend tomorrow -

HMjr: Yes

C: And they meet on Sunday and Monday.

HMjr: Who does?

C: The Bank meets - the B. I. S.

HMjr: Oh, yes.

C: So I'll be back Tuesday morning.

HMjr: All right.

C: And Tannery is going also.

HMjr: Yes

C: And so we expect nothing - no turnover of any kind here this week.

HMjr: I see.

C: Although the Left is urging Sarraut to get out and make way for Blum.

HMjr: Yes

C: But if the situation doesn't get any worse why that's unlikely.

HMjr: Yes. All right, thank you. Good -

C: I'll wire you Tuesday and I'll have my assistant wire you probably Monday.

HMjr: All right -

C: Goodbye

HMjr: Thank you.

132

May 8, 1936

193

Meeting held in Secretary Morgenthau's office at 10:30 on Housing

Present: Secretary Morgenthau,
Jesse Jones
James B. Alley, General Counsel RFC
Mr. Bell
Mr. Opper

Mr. Jones: Read off items one and two.

Mr. Jones: No. 3 provides the right to borrow from the RFC 100 million without security.

Mr. Jones: No. 4 - Right to issue notes guaranteed by the government for the next three years.

Mr. Jones read on and after he had read the sentence, "the grants may be in the form of annual subsidies" he said, "that may be any direct grant."

Mr. Morgenthau: Have you some ideas about it.

Mr. Jones: Have a good many ideas about it but it is hard to take the bill and show what it will do.

Mr. Morgenthau: Let's take it from the money standpoint. He said between 8 and 9 million.

Mr. Bell: What is that for?

Mr. Jones: I don't know.

Mr. Morgenthau: He had a direct appropriation of 51 million.

Mr. Bell: That is right.

Mr. Jones: I have not been able to find out from Colonel Hackett or Clas or get an estimate of what they thought they could spend or should spend within a fiscal year but that 9 million was really to pay that extra rent - the subsidy.

- 2 -

Mr. Bell: The money made available for the grant over and above --

Mr. Jones: Yes - instead of giving them 45% we will let them pay their rent.

Mr. Opper: It was to give them everything over \$6.00 rent for 45% of the balance - 45% of the \$6.00.

Mr. Morgenthau: You mean 45% of the \$6.00?

Mr. Opper: That's right. I got that through Oliphant.

Mr. Morgenthau: Let's say the building costs 1 million. As I understand it the New York Housing Authority builds a building for 1 million and I understood it that \$550,000 is raised in the State of New York and that \$450,000 will be loaned by the federal government and then the fellows pay less so the rooms are worth \$10.00. The tenant pays \$6.00 and the federal government pays \$4.00 - is that wrong? Is that the way it is in the bill?

Mr. Opper: In the bill it is different again. Regardless of what the cost of the project is as compared to the rentals they can get they can grant up to 45% of the total cost.

Mr. Morgenthau: Is it true that we can only lend money to the State Housing Authority?

Mr. Opper: You can lend it to a Mortgage Dividend Company under the bill.

Mr. Morgenthau: Well don't they raise any money?

Mr. Jones: No requirements on this bill.

Mr. Opper: Can I give you the pattern of the present bill. The Housing Authority, under the Wagner Bill, can grant 45% of the total cost regardless of how much is received in rent. They give them 45% and never get it back and they can rent all of the rest. In the case of a Limited Dividend Company they can't make any grant but can lend up to 85% of the cost. The rent stuff was injected for the first time in the new proposal - not in the bill.

Mr. Morgenthau: Isn't that in the bill?

Mr. Opper: That is with respect to the amount of money that the government will give.

Mr. Alley: This grant may be in a lump sum or may be in fixed contributions over a period of 60 years.

Mr. Opper: You start out with a grant - you can either give 45% in a lump sum or capitalize it on an annuity basis and pay off 1/60th each year but total amount is only 60%.

Mr. Morgenthau: My father made money out of real estate and so did Jesse.

Mr. Jones: Yes I made money and lost too.

Mr. Morgenthau: Give them the \$450,000 and get through with it.

Mr. Jones: That's all right, Henry, except you don't get ---

Mr. Morgenthau: I know but if you give them that then you are through because at the end of the 50th year we would have to build.

Mr. Jones: You are never going to get through as long as you have Congress. If you give them 45 this year you will have to give them part of the 55 next year. I want to explain this. If that room ought to rent for \$10. in order to pay 85% on the investment and a fellow can't pay this we have to give him this \$4.00 some way. You will give him the 450 but the only grant to pay is rent. You don't do both - you do one or the other.

Bell: Section 9 provides for a grant.

Mr. Morgenthau: Let's think out loud for a moment. Up to now we have taken the position, unless something happened last night, that anything that is not in the budget is out.

Mr. Jones: This is not in the budget - is it no part of it?

Mr. Bell: No part of it.

Mr. Morgenthau: Now what will it do then? That seems to be in the President's mind that you have to have some grant. I think he said they are asking for 51 million but they are not going to spend it but hell it shows up. If you give them 51 they spend 52.

Mr. Jones: But Wagner - I think you have to find some way to give him some grant for the first year.

Mr. Morgenthau: I have a radical suggestion to make. Everybody admits that the housing that Ickes has done is nothing but slum clearance - is that right Jesse?

Mr. Jones: That is right.

Mr. Morgenthau: The suggestion I will make is that if I take this bill I would have to take anything Ickes has planted in his low cost housing organization - so many millions of dollars.

Mr. Bell: I don't know how much - 170 or 140 million - some is obligated and some spent but very little has been spent.

Mr. Morgenthau: Why don't we say to this organization - stop this building of low cost housing. Low cost housing does compete with private capital and let's do what we all talked about - make Ickes' organization into a real slum clearance organization and change the rules and regulations so that it is really a slum clearance organization.

Mr. Jones: At first blush that sounds good. That would get over your immediate grants but you have a good many hurdles to go over with Wagner. I think you can get your first money out of this business here - this 140 million but I think you would have a hard time to satisfy Wagner with just that.

Mr. Bell: What chance has this bill - you only have a month of Congress left.

Mr. Morgenthau: I am not going to say you don't need slum clearance but I am going to say the money is there.

Mr. Jones: I have been talking along that line with Hackett. You go to Atlanta and build a nice building. Congress is thinking about slums of New York, Pittsburgh, Chicago. You don't need it in St. Louis, Dallas, etc.

Mr. Jones: I am not going to get into an argument but how much has Ickes got left? Could you give us some idea as to how much of this 140 is available and so on and then I will work out a program and come back here Monday or Tuesday.

Mr. Morgenthau: Are we thinking alike?

Mr. Jones: Yes absolutely.

Mr. Bell: It is the same old story you will run up against - only 30 or 40 million actually obligated. It is all committed and they may have gone out and let contracts for the foundation. We will say they have not let contracts for the foundation so to that extent the money is committed but it is not actually obligated.

Mr. Morgenthau: What is the total sum he has for low cost housing?

Mr. Bell: He had a little over 100 million.

Mr. Morgenthau: Opper was in this low cost housing in New York - he knows all about it.

Note: While Mr. Morgenthau was telling Mr. Jones that Opper knew all about this low cost housing, Bell was checking his book for the total sum which Ickes had for low cost housing.

Mr. Bell: 101 million allocated out of the 4 billion 8 by the President for housing. 27 million of that is obligated and 13 million 800 thousand has been spent.

Mr. Morgenthau: Yes but Dan back of that was the old 3 billion 3.

Mr. Alley: What date is that?

Mr. Bell: April 20th.

Mr. Jones: I think we can check this thing and work out a plan and I will get it back here. There is no hurry as Wagner left for New York and won't be back until after Monday or Tuesday.

WAGNER BILL

Capital Funds

1. Transfer of property now belonging to PWA of the approximate value of \$140,000,000.
2. Federal appropriation of \$51,000,000 for the first year
\$75,000,000 for the second year
\$100,000,000 for the third year
\$100,000,000 for the fourth year.
3. Right to borrow from the RFC \$100,000,000.
4. Right to issue notes guaranteed by the U. S. Government,
\$100,000,000 for the first year
\$150,000,000 each for the next three years

Bill provides for a Board of 5.

No limitation placed on type of demonstration projects to be wholly financed by Federal Government.

Authority is authorized to make grants up to 45% of the cost of land and buildings to public housing agencies, and may loan to limited dividend corporations up to 85% of the cost of land and buildings, to the amount of \$25,000,000 per year for four years.

The grants may be in the form of annual subsidies

Loans may be made for as long as 60 years.

INDEX

NEW ORLEANS CASES

May 9, 1938

Memo from Ireys, attaching report from Special Agent in Charge Buford, advising of disposition of five cases in New Orleans.

May 19

Memo from Ireys reporting further on disposition of New Orleans cases.

May 20

Memo from Ireys and attached report from Buford. Ireys says Jackson trying to arrange conference to discuss the handling of New Orleans cases.

May 22

HM, Jr. called Bob Jackson to raise question with him, officially, as to whether or not Viosca was fit to try the New Orleans cases.

May 23

HM, Jr. spoke to Attorney General about Viosca and inquired of him if he was not disturbed. Attorney General said no; nothing to get really disturbed about.

June 1

HM, Jr. spoke to the President ; told him Viosca's name was going to be recommended for District Attorney of New Orleans and that under no circumstances should his name be sent up for confirmation.

August 10

Letter prepared by Gaston to Editor, NY Herald-Tribune contradicting information contained in their editorial of August 8.

August 11

At lunch with Atty. Genl., HM, Jr. said he thought it would be mutually advantageous to have Bob Jackson try the Louisiana tax cases. Jackson's secretary said he did not want to, but Cummings will personally get in touch with him. Atty. Genl. advised against sending letter to NY Herald Tribune saying Treasury was "in the clear."

BUREAU OF INTERNAL REVENUE
OFFICE OF
CHIEF, INTELLIGENCE UNIT

201

May 9, 1936.

MEMORANDUM FOR THE SECRETARY:

Attached is a communication from Special Agent in Charge Burford at New Orleans, in which he advises that on May 6th Rudy O'Dwyer, George O'Dwyer and C. A. Kenney appeared in court before Judge Rufus E. Foster, senior member of the Circuit Court of Appeals, and entered pleas of guilty to all counts in the indictments against them. They were fined, respectively, \$4500, \$3500 and \$1500 and were required to pay the taxes and penalties charged to be due. The total of these taxes and penalties was \$85,401.00, which, together with the \$9500 in fines, made a total of \$94,901.00.

Last evening I received a telegram from Mr. Burford advising that yesterday afternoon Manasse Karger and Marks Karger appeared before Judge Foster, plead guilty and were fined \$1,000 each. They, likewise, were required to pay their taxes and penalties which totaled \$20,380.00.

There was, consequently, received from the five defendants in taxes, penalties and fines a total of \$116,880.

Of the seven cases now disposed of in New Orleans, one (Joseph Fisher) resulted in conviction and sentence to eighteen months in the Penitentiary; five (those enumerated above) resulted in pleas of guilty; and one (Abe Shushan) resulted in an acquittal, or a total of six cases won out of seven disposed of.

There are remaining in this series of cases indictments against Joseph Haspell (recognized as an anti-Long man); Jules Fisher (a member of the State Legislature and a relative of Joseph Fisher, already convicted); Seymour Weiss, Nick Fernandez, The Hartwig Moss Insurance Agency, which is a conspiracy charge involving Joseph Myers, Seymour Weiss and Mike Moss; the Louisiana Quarry Company, which is a conspiracy charge involving R. S. Wilson, Seymour Weiss, C. D. Nichols and H. S. Schiff; and the Mississippi Valley Company, which is a conspiracy involving

John P., Harry B. and W. N. Nelson.

The Louisiana Quarry Company case and the Mississippi Valley Company case are set for trial in June before Judge Borah, and the agents, with the United States Attorney, are busily engaged in preparing these cases for trial.

Mr. Burford tells me on the telephone this morning that there are rumors around that Haspell, Fisher and Fernandez may possibly plead guilty. If this happens and the two cases set for trial in June are disposed of, that will leave one conspiracy case (The Hartwig Moss Insurance Agency) and the individual charge against Seymour Weiss, to be disposed of.



TREASURY DEPARTMENT

203

INTERNAL REVENUE SERVICE

INTELLIGENCE UNIT

New Orleans, Louisiana, May 6, 1936.

Dallas

(Name of Division)

SI-10513-F AIR MAIL.
SI-10514-F
SI-10397-F

Personal and Confidential.

Chief, Intelligence Unit,
Bureau of Internal Revenue,
Washington, D. C.

Dear Mr. Irey:

In re: Rudy O'Dwyer,
George O'Dwyer,
C. A. Kenney.

As related to Mr. Woolf by telephone, the three above-named parties appeared in court and entered pleas of guilty to all accounts in the indictments and were fined as follows:

C. A. Kenney	\$ 1500
Rudy O'Dwyer	4500
George O'Dwyer	3500

I was advised by United States Attorney Viosca yesterday afternoon, May 5th, and asked to treat the same in confidence, which I did, that he had been advised by Judge Rufus E. Foster, senior member of the 5th Circuit Court of Appeals, that he had been approached as to receiving pleas of guilty from the gamblers. This morning, just prior to ten thirty, I was in communication with Mr. Viosca on another matter, and he advised me that Judge Foster had just sent for him and asked that I come over. Upon my arrival, the Judge had just taken the bench, and former United States Attorney Edmond E. Talbot, who is now occupying the position of Referee in Bankruptcy, and his brother, Harry Talbot, counsel for the above-mentioned parties, made the statement that they wished to withdraw their former pleas of not guilty and enter pleas of guilty to the respective indictments.

The United States Attorney asked the Court if he desired to hear evidence from the agents as to the facts, and he stated that he did not care to hear such evidence either from the agents or the United States Attorney, and that the indictments spoke for themselves. He then said to counsel that he preferred not to consider sentence until he knew what disposition they proposed to make of the "unpaid taxes" (this was his exact language) referred to in the indictments. He made other references to the charges as failure to pay their taxes.

The Court's attention was then called by the United States Attorney to the fact that in addition to the taxes where fraud was alleged, a civil evasion penalty of 50% was applicable. The Court then stated that that amount should be added to the tax as shown in the indictment, and that those sums should be placed with the clerk of the court for the account of the Collector of Internal Revenue in the form of certified checks, and that if such was done he had in mind the imposition of fines. The court was then adjourned for a few minutes to afford the defendants an opportunity to carry out the Judge's expressed wishes. When this was done, he imposed the sentences above related and committed the defendants to the custody of the Marshal pending the payments of the fines, which were immediately accomplished.

It has been the practice on occasions, so I am informed, for Judge Foster to hear pleas of guilty during the absence of Judge Borah, who is at present away on his wedding trip, and I am informed that a day or two prior to Judge Borah's departure, at a conference between the United States Attorney, Judge Borah and Judge Foster, Judge Foster had stated that he would take care of pleas during Judge Borah's absence.

It was observed by one of our employees on May 4th that Attorney Talbot was in conference with Judge Foster, and we also know that Judge Robert Rivarde, Judge of the 24th Judicial District of the State of Louisiana, was in conference with Judge Foster prior to the entering of the pleas. Judge Rivarde was referred to by others under investigation sometime ago as having advised them to file amended returns when the investigations were instituted. His district includes Jefferson Parish,

SI-10513-F; SI-10514-F;
SI-10397-F

where the O'Dwyers operate their gambling institutions, and he is known to be on good terms with them. Upon leaving the Court, after sentence was imposed, he waved his hand to Judge Foster, who was then on the bench, and very affably said "good bye".

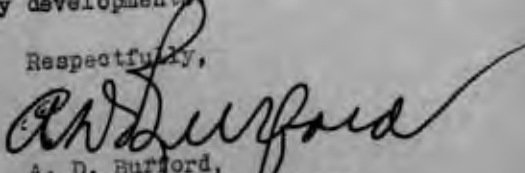
Judge Foster stated in connection with the certified checks which were placed with the clerk of the court that it was to be understood that the payment of this amount of money was not to prejudice the taxpayer's rights to secure an abatement, or refund, of the taxes, or the Government's right to assert additional taxes, interest and penalties, in appropriate civil actions. This, of course, was most unusual, and I suggested to the Assistant United States Attorneys handling the matter (the United States Attorney had to leave to take care of private litigation in the State Courts) that it might be well to discuss that provision with the Court as it was not making a clean cut issue of the payment of the taxes and was likely to be the basis for unnecessary civil litigation, but in view of the Court's stated attitude, they were not inclined to make any mention of it to him, and did not do so. He stated that judgment should be prepared accordingly, and there are attached hereto copies of the receipts given to the defendants in exchange for these payments, which incorporate that provision, so far as the defendants are concerned.

Personally, and without insinuations to anyone, I have the private opinion that the action which took place today was in the making sometime ago.

As an interesting side light, Herman B. Deutsch, a feature writer for the "Item-Tribune", told me that during the adjournment while the Court was awaiting the return of the defendants, with their certified checks, Kenney approached him with a \$50 bill in his hand and attempted to get Deutsch to accept it as a fee for not giving him a bad write up. This made Deutsch very furious, but he asked me to treat the matter in strict confidence.

It is not known whether other defendants will appear and enter pleas before Judge Borah's return, but you will be kept advised promptly of any developments.

Respectfully,


A. D. Burford,
Special Agent in Charge.



2 O'DWYERS GUILTY, FINED

Hold Hunter for Harboring Karpis; Bail \$200,000

O'Dwyer Brothers, Their Friend Judge Rivarde



The O'Dwyer brothers smiled broadly Wednesday after they had pleaded guilty to violation of the income tax laws and received a fine at the hands of Federal Judge Rufus E. Foster. In the picture, from left to right are GEORGE O'DWYER, JUDGE I. ROBERT RIVARDE of Jefferson parish, and RUDOLPH O'DWYER.—(Photograph by the New Orleans States.)

2 O'DWYERS, KENNEY PLEAD GUILTY IN U. S. TAX CASES, PAY FINES

Rudolph and George L. O'Dwyer, Jefferson parish gamblers, and Courtney A. Kenney, St. Bernard parish gambler, charged with evasion of income taxes for the year 1935-36, appeared before Federal Judge Rufus E. Foster Wednesday morning and pleaded guilty to the charges.

The plea of guilty came as a complete surprise at the trial of Kenney had recently been postponed because of the absence of Federal Judge Wayne G. Stark, who is on his honeymoon. Judge Foster, a member of the circuit court of appeals, announced that the plea of guilty would be accepted on payment of the amount which the government charges is due the government, plus a 50 per cent penalty.

"I don't believe in sending men to

prison when they plead guilty unless it is absolutely necessary," said Judge Foster. "I would be disposed to impose fines rather than sentences."

What Each Must Pay
Edmond E. Talbot, attorney for the three men, was instructed by Judge Foster to obtain certified checks for the amounts due the government and present them in court.

The amounts were \$22,541.25 for Rudolph O'Dwyer; \$22,541.25 for George L. O'Dwyer, and \$10,117.75 for Courtney A. Kenney.

Rudolph O'Dwyer was fined \$450, his brother, George, \$200 and Kenney, \$100.

The taxes were paid with certified

Continued on Page Two

ANS STATES

O'DWYERS, KENNEY 'GUILTY,' ARE FINED

Pay Full Levies Demanded
by U. S., Plus 50 Per
Cent Penalty

Continued from Fly Sheet

checks and the fines with personal checks by the men.

There was a spirit of levity prevalent throughout the pleading of guilty by the three men.

When the offer of a plea of guilty was made by Mr. Talbot to Judge Foster he was told to "go out and draw certified checks and I will impose sentence."

"These cases could have been compromised after indictment," added Judge Foster. "Are you prepared to make payment?"

"Yes, sir, we can give bona fide checks right now," replied Mr. Talbot.

"Yes, but you could stop payment on those checks, though I don't say you would," replied Judge Foster. "Ed, you get those checks certified and come back here. I will be here all day because I have to remain in court."

Mr. Talbot, accompanied by his clients, immediately left the building to have the checks certified and returned a short time later.

Karger Brothers Cases Fend

The checks are made payable to the order of the court and will be deposited in the registry of the court and held for the collector of internal revenue for the eastern district of Louisiana.

"Am I to understand that we still reserve our civil rights?" asked Mr. Talbot.

"Certainly, you could never waive that right," replied Judge Foster.

The O'Dwyers and Kenney were indicted some time ago on charges of attempting to evade payment of income tax. Marx and Manasse Karger, also Jefferson parish gamblers, who at one time were partners of the O'Dwyers, are also under indictment on similar charges.

Courtney A. Kenney, operator of the Arabi Club in St. Bernard parish, was indicted by federal grand jury on November 15, 1934 on charges of attempting to evade income taxes of \$6076.84 in 1929, 1930 and 1931. According to the indictment, in 1929, Kenney reported gross income of \$2300, net of \$902.68, on which he paid an income tax of \$48.65; whereas gross was \$18,980.15, net \$17,736.30, tax due \$479.67; in 1930, he reported gross of \$6530, net of \$5733.24, paid \$27.73; whereas gross was \$45,261.24, net \$43,902.76, tax due \$4004.55; in 1931, he reported a gross community income of \$15,100, paid \$101.82 and same amount for his wife; whereas gross was \$50,601.28, net \$58,140.50, tax due from each \$1534.35.

Rudolph T. O'Dwyer and George O'Dwyer, operators of the Original Southport Club, were indicted by federal grand jury on February 15, 1935, on charges of attempting to evade income taxes for 1929, 1930 and 1931 as follows: Rudolph, \$29,288.87; George, \$22,535.62. According to the indictment:

Rudolph O'Dwyer, in 1929, reported gross of \$10,461.19, net of \$9386.19, paid \$92.60; whereas gross was \$92,323.51, net \$90,354.50, tax due \$12,875.15; in 1930, he reported gross of \$34,810.81, net of \$13,735.81, paid \$576.07; whereas gross was \$77,658.24, net \$73,497.41, tax due \$9639.46; in 1931, he reported gross of \$14,834.10, net of \$12,800.20, paid \$641.78; whereas gross was \$63,631.12, net \$60,054.66, tax due \$7041.

George O'Dwyer in 1929 filed no return; whereas gross was \$44,774.58, net \$43,791.59, amount due \$850.92 and an equal amount from wife, on community return basis; in 1930, he reported gross of \$16,587, net of \$16,317, paid \$658.41; whereas gross was \$61,663, net \$58,539.74, tax due \$6685.59; in 1931, he reported gross of \$14,566.90, net of \$14,314.90, paid \$727.13; whereas gross was \$98,602.31, net \$94,292.05, tax due \$14,670.76.

THE NEW ORLEANS ITEM

Fifty-Ninth Year—331

Wednesday Evening, May 6, 1936

Price 3 Cents

CO

Baton Rouge Bridge C

O'Dwyers, Kenney Plead Guilty; Fined

Gamblers Freed In Tax Fraud

Three Pay U. S. On Evaded Levy

Courtney A. Kenney, operator of the Arabi club in St. Bernard parish and Rudy and George O'Dwyer, of the Original Southport Inn, all prominent New Orleans gamblers pleaded guilty before Federal Judge Rufus E. Foster today, agreed to pay the government their delinquent income taxes plus all penalties, and were assured of no jail sentences by the court.

Kenney was the first to pay off his debt to the government, and stood before the bench awaiting sentence.

"We don't want to put this on a percentage basis, Mr. Kenney," said Judge Foster, a twinkle in his eye. "I guess \$1,500 will be enough. That's the fine."

George O'Dwyer who next presented his certified check to the court received a fine of \$3,500. His brother, Rudy, followed, and was fined \$4,500.

All the fines were paid, and the three walked out of court free of all charges.

Foster Hears Pleas

The three gamblers were represented by Edmond E. Talbot, referee in bankruptcy and former U. S. Attorney here. Judge Foster heard the pleas in the absence of District Judge Wayne G. Borah who is on his honeymoon.

When the pleas had been entered, Judge Foster said:

"These cases could have been compromised even after an indictment. I do not believe in jail sentences in tax cases where the amount sought by the government is actually paid to the collector."

A Laugh Brought Out

Talbot then announced that the defendants were ready to turn over certified checks to the registry of the court for the taxes owed plus penalties, pointing out at the same time that each defendant was entitled to credit for sums paid to

Gamblers Go To Court; Walk Out Free Men



Candid camera shots when Judge Rufus E. Foster fined Courtney Kenney, Rudy O'Dwyer, and George O'Dwyer, after the latter had pleaded guilty to charges of income tax evasion. Above at the left, COURTNEY KENNEY, standing beside his attorney, EDMOND TALBOT, before Judge Foster, as he turned

over a certified check for back taxes plus a \$1,500 fine. At the right, GEORGE O'DWYER, surrounded by attorneys, as he stood before the bar. Below, left to right, GEORGE O'DWYER, JUDGE ROBERT RIVARDE, of the Jefferson district, and RUDY O'DWYER, leaving the Federal building.

(CONTINUED ON NEXT PAGE)

Gamblers Plead, Fined And Freed

(CONTINUED FROM PAGE ONE)

the collector since the investigation began.

"Well," drawled the court, "you could stop payment on checks, you know; but then I guess you wouldn't do that."

In the laughter that followed he added: "Go ahead and get the checks certified. Make them payable to Rufus W. Fontenot and then we'll talk about sentences."

What They Are Paying

With the penalties included each of the three defendants paid in addition to the fines:

Kenney—\$10,117.78.

Rudy O'Dwyer—\$42,741.93.

George O'Dwyer—\$22,541.29.

Kenney was scheduled for trial on June 1, just as soon as Judge Borah returns from his brief vacation.

Their pleas of guilty are the first such pleas since government agents began their sweeping investigation of income tax evasions in Louisiana.

Has Many Friends

Kenney was indicted in November, 1934, the true bill charging evasion of \$8,076.84 in income taxes during 1929, 1930 and 1931; that he

concealed an income amounting to approximately \$88,000. He operated the Arabi club for 15 or 18 years and was in charge of the club at the time the late Huey P. Long made his sensational gambling raids in St. Bernard parish. Among gambling patrons he has many warm friends who vouch for him as being "on the square."

The O'Dwyer brothers were indicted last February, the true bill being returned on the same day that the indictment charging Manasse and Marks Karger with in-

come tax evasion was handed down. Rudy O'Dwyer was charged with evading payment of a tax of \$29,280.07 on an alleged gross income of \$233,525.17 and his brother, George, with evading payment of \$22,333.32 in income taxes on a gross income of \$204,918.78 for 1929, 1930 and 1931.

The O'Dwyers were associated with the Kargers in the operation of Club Forest in Jefferson parish, and for years before Club Forest opened, operated the Original Southport Inn.

Father Goes To See Son First Time In 40 Years

(By The Associated Press)

RONAN, Mont., May 6.—A Mr. Noble arrived from Sac City, Iowa, and immediately asked the postmaster if he knew a Ronan citizen named R. C. Noble. The postmaster did, and would take him to his home. When he saw the Iowa visitor R. C. Noble exclaimed: "Why dad, where did you come from?" It was their first meeting in 40 years.

British Red Cross Leader Dies Of Wounds

(By The Associated Press)

LONDON, May 6.—Dr. A. J. Melly, leader of the British ambulance unit in Ethiopia, who was wounded Sunday during native riots in Addis Ababa, died last night in the British legation, his relatives were informed officially today. Dr. Melly was shot in the lungs Sunday afternoon while dragging wounded in from the streets.