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April 1, 1936

At the staff meeting this morning, Mr. Oliphant told Mr. Taylor that he should not have discussed Section 403 of the Omnibus Liquor Bill with the representatives of the Canadian liquor industry; that Eli Frank was not prepared to discuss the various phases of the legislation nor the Treasury policy and, therefore, should not have been called upon to make an impromptu explanation. He reminded Taylor that it was not the purpose of the meeting with the Canadians to discuss the legislation; that these people had tried to see both the Secretary and himself for the past year, but Mr. Morgenthau definitely did not want to see them. Taylor's reply was that "they challenged us and someone had to answer them," and that was why he called on Eli Frank.

It was decided (1) that we should equip the State Department with the correct information so that they can defend our legislation, and (2) that pursuant to the President's instructions we will proceed with the hearing on this bill tomorrow.

April 1, 1936

HM, Jr. told Taylor yesterday that he wanted Bell to "carry the ball" on the financing program of the Farm Credit Administration.

Last night, when HM, Jr. spoke to Bell by telephone from Sea Island Beach, Bell told him that Taylor had given him the message; that is, that HM, Jr. expected Bell to "carry the ball" on the Farm Credit Administration financing.

Bell reported to HM, Jr. that two days ago, Taylor acted as though he was Bell's superior and, therefore, Bell left the thing entirely with Taylor. HM, Jr. definitely told Bell that until an Under-Secretary was appointed that he (HM, Jr.) personally would handle all the financing and when he was away he would rely on Bell and Burgess and not on an Assistant Secretary.

Wednesday
April 1, 1936.

HMjr: Hello -
H. S.
Klotz: Just a second -
W. C.
Taylor: Good morning

HMjr: I don't hear you very well.

T: I say, good morning! (pause)
Well, the liquor boys went away, I don't know how happy -

HMjr: Yes

T: But I think it worked out about as well as it could have.

HMjr: You mean they've gone back to Canada?

T: Yes

HMjr: Yes

T: And we're going to go over all the things that were developed in those conferences and then report back.

HMjr: Yes

T: I -

HMjr: I don't know what the rates are for breakfast at two-thirty in the morning but I understand that your son came back with mine and had breakfast at my house at two-thirty this morning.

T: Well, whatever the proper charge is -
(Laughter)

HMjr: They're having a grand time together, anyway.

T: Yes - well, he's a nice boy.

HMjr: A very nice boy.

T: I'm glad you like him.

HMjr: A very nice boy.

T: I forgot to tell you yesterday that the Welles situation is all quiet.

HMjr: All quiet?

T: Yes

HMjr: You spoke to Welles?

T: I spoke to Welles and he said, 'Well as long as the Secretary has communicated direct why that's all I want to know about'.

HMjr: And, - I never had a chance to ask you whether you agreed with me or not.

T: I do completely.

HMjr: Yes - I told - in my telegram to the President I said I didn't want officially or unofficially to have monetary matters discussed at this coming South American Conference.

T: Yes - Well, I - I passed that on to Welles and he seemed very pleased.

HMjr: He did?

T: Yes

HMjr: Gosh! the State Department and I agree, maybe I'm wrong!

T: (Laughter)

HMjr: Sounds like

T: Yes - there's one other thing in Diplomatic relationships -

HMjr: Yes

T: And that is that Butterworth -

HMjr: Yes

T: - says he cannot disclose who his pals are in England.

HMjr: Oh -

T: - on account of its having been given him in confidence. Now, I'll send that - as soon as that cable comes over I'll send it down to you -

HMjr: That's right.

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T: I guess it did go down last night. And you can fix that over if you'd like to.

HMjr: Well, I'd ask Phillips what one would do under those circumstances - they're on his payroll, see?

T: Yes

HMjr: Ask Phillips what one does under those circumstances. Should we force the issue or should we let it - forget it?

T: Yes

HMjr: On that thing I'm perfectly willing to do whatever Phillips says.

T: O. K.

HMjr: Whatever he says. Afterall, if he was working for me he'd give me the source or he'd retire.

T: I - I would say so.

HMjr: If he's working for Phillips I'll let Phillips make the decision.

T: All right.

HMjr: See? Because, after all, the source of the information might stamp it with authority or it might just be foolishness.

T: Yes

HMjr: But, let Phillips make that decision.

T: All right, I'll get to talk to him this morning about the Canadian thing so I'll bring that in.

HMjr: All right. Is Bell around?

T: Yes, right here -

D. W. Bell: Good morning -

HMjr: Hello, Bell?

B: Yes, sir

HMjr: What's the batting average on Tugwell getting his money?

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B: (Laughter) Well, I haven't yet decided what to do. But the way the thing is shaping up in my mind I thought I'd send a wire to the President stating my understanding of the situation at the time he gave consideration to the Crop Loan Bill -

HMjr: Yes

B: - and the time he signed the Executive Order allotting thirty million.

HMjr: Well, you know, - see if my memory is any good, the President said to Bill Myers, 'Try to get along with fifteen million - '

B: Right

HMjr: 'the outside figure twenty' - ?

B: That's right.

HMjr: Is that right?

B: That's right.

HMjr: O. K.

B: But, further, as I recall, he said in that Conference that Bill Myers would not have to worry about Tugwell's clients- and in his message to Congress he said that what he would do - what we should do is get away from the Crop Loan business.

HMjr: Well, I don't - unfortunately I don't remember that.

B: Well, he said we'd get away from this Crop Loan business eventually.

HMjr: Yes

B: Now, he said, 'I realize that there are still some farmers who are right on the market and if we don't give them a loan will probably seek relief from some other Government authority.'

HMjr: Yes

B: Now he wanted to prevent that.

HMjr: Yes

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B: So he - that was the reason for the thirty million. And as I recall, he told Bill Myers that he would not have to take care of Rex Tugwell's clients.

HMjr: Well, I can't remember either way on that.

B: Now, if I set that out in a cable I think I'll say that if this - if my recollection is correct - 'I suggest you send the following cablegram to Rex Tugwell.'

HMjr: Yes

B: And then tell him that Bill Myers was not to make any loans to his clients and he'd take care of them.

HMjr: Well, that would suit me.

B: Or, if he'd prefer -

HMjr: I think it's perfectly silly -

B: How is that?

HMjr: - for Bill Myers to lend money to Tugwell's people.

B: Well, it does seem kind of silly. Of course they're contending now -

HMjr: I think that would be plain stupidity.

B: They're contending down there now that if the Crop Loans are made to these relief clients - that the loans ought to be made by Bill Myers because he's got the organization.

HMjr: Well, that's -

B: And that if they've got to furnish the money it ought to be transferred from them to Bill Myers.

HMjr: And then they'll lend the money to their clients and pay Bill Myers back I suppose?

B: No, they've got two classes of clients.

HMjr: I know.

B: One is the - what they call the 'standard loan client' - the ones they are making loans to "rehabilitate."

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And the other is ones they're giving direct relief - eighteen dollars a month for subsistence, out of which they claim that they can't buy feed. But all of our pressure is coming from the Northwest and the grain areas and in those sections which we tried to hit by lowering the individual loan from five hundred to two hundred.

HMjr: Well, I'm glad that you're getting it off to the President.

B: Well, I hate to send him a wire at all.

HMjr: Yes

B: And I think I'll try to get Tugwell and Bill Myers together today and see if they can't work it out.

HMjr: Yes

B: - or wait until he comes back.

HMjr: Anything else?

B: That's all. I'm going on the Hill this morning to see Buchanan on the CCC and the -

HMjr: Anybody else want to talk to me?

B: Archie will just tell you about the exchanges.

HMjr: Is McReynolds in the room?

B: No - want him?

HMjr: No, but you can tell him, I want to get out an Executive Order that every member of the nine-thirty staff has -

B: Has what? Hello?

HMjr: Hello

B: Yes

HMjr: Tell Mac to get out an Executive Order that every member of the nine-thirty staff has to read the article in this week's Saturday Evening Post by Stout - the Government -

B: They keep cutting you off.

HMjr: What?

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B: They keep - The Government what?

HMjr: There's an article by Stout -

B: Yes

HMjr: - in this week's Saturday Evening Post.

B: That's right.

HMjr: - that I suggest that everybody read.

B: All right.

HMjr: On - it's called, "The Government Builds Fifty Houses".

B: Oh, I see, all right, we'll tell him.

HMjr: It's the darndest expose I've ever read.

B: Well, we'll read it.

HMjr: I really think everybody ought to read that.

B: All right, we'll tell him.

HMjr: If I had an organization like that - and - and the fellow writes it by quoting AP dispatches, you see?

B: Yes

HMjr: So there isn't much argument about it.

B: (Laughter) Say, I checked up a little on that noise yesterday we had on the phone.

HMjr: Yes

B: And - Miss Corrick did, rather, and she made the telephone officials check it clear through to you.

HMjr: Yes

B: And they found out that there was a terrible electric storm -

HMjr: Yes

B: - some place in Alabama and they hit the wires.

HMjr: That's what my operator said.

B: Well that's checked then.

HMjr: Right

B: Corrick was right worried.

HMjr: I'll talk to Archie.

B: All right.

Archie
Lochhead: Hello

HMjr: Hello, Archie?

L: Well, they - see they've recovered their nerve somewhat on the other side now -

HMjr: Good!

L: They've got the francs up to six fifty-nine and a half.

HMjr: How about gold?

L: Gold is still holding up - the rate is still five cents too high to get anything in London. There's no gold - no more gold coming from Paris -

HMjr: Archie - that cable that came in from Buck about this Conference in May - do you understand where those places are and what they are going to do?

L: Well, I'll tell you we had yes.
Here's the point, there are two provinces - there is one, the Province up North, up near Japan, the Hopee Province and the other Canton Province is down - is down in the South. In other words they - in Central China they're getting somewhere with their currency. But up in the northern part and down in the southern part they're having trouble trying to get them to unify their currency with the national currency.

HMjr: I get it.

L: So I think it was - by the way, one word in that cable that mentioned 'Yuan' -

HMjr: Yes

L: - happens to be a man's name we found out later.

HMjr: Oh -

L: I had an awful job - I thought at first he was speaking about currency and then I thought a 'Yuan' also means

an executive session.

HMjr: Yes

L: But we found out by looking in the Year Book that that one happened to be his name.

HMjr: Yes

L: So that's - 'So and so Yuan, head of the Province' - that's the man's name.

HMjr: Am I on the air?

L: Yes (Laughter)

HMjr: All right.

L: But that's what that really explains there, that they're having trouble both up in the northern part and in the southern part.

HMjr: I see.

L: And they're trying to get them unified.

HMjr: All right.

L: O. K., sir - Is there anybody else you wish to speak to or be connected up with?

HMjr: Well, I'll talk to the operator and - is Mrs. Klotz going back to her room?

L: If you want her to, yes.

HMjr: Yes, I do.

L: O. K. then

HMjr: Goodbye.

L: Goodbye, sir.

Wednesday
April 1, 1936.

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HMjr: Well -- for the first eight months of this fiscal year -
Herbert E.
Gaston: Yes

HMjr: That takes us up to March third.

G: Yes

HMjr: What our estimate was and then what the actual was -

G: Yes

HMjr: And compare it with four previous years.

G: Yes

HMjr: See?

G: Yes

HMjr: That's one total.

G: Yes

HMjr: And then the next total - the figures for the thirty-one days of March - what our estimates were -

G: Yes

HMjr: - and what the actual was -

G: Yes, yes

HMjr: Compare that with four previous years.

G: Yes, yes - yes

HMjr: nothing new in that but here's a new one.

G: Yes

HMjr: I want that broken down by States.

G: How? - yes

HMjr: And because the papers will carry - each State will carry

G: Yes, they will, you're right.

HMjr: What?

G: Yes

HMjr: And that I think you knew

G: Yes, yes

HMjr: Here's something which you will have to use your judgment on.

G: Yes, yes

HMjr: I would very much like to carry the estimate for each four years for the same period, see?

G: Well -

HMjr: But that's a little dynamite. We may have been - we may not have been so hot, I don't know.

G: Yes

HMjr: I'll let you pass on that.

G: Yes, well now, I think of just one thing in this connection that might affect it, and that's this. As I - as I look at the daily statement the income tax collections, corporation and individual, are very very close to the estimates. They won't be more than three or four per cent over.

HMjr: That's right.

G: But, the all collections, all revenue is - is almost, well, the comparison is - we estimated a sixteen per cent gain and we've got a twenty-three per cent gain. And it'll make a difference of about two hundred and sixty-seven millions we'll get - on that basis we'll get about two hundred and sixty-seven millions more revenue this fiscal year than we estimated. Now, the only danger in that is giving that to the Committees -

HMjr: I didn't suggest that.

G: No -

HMjr: Ah ha -

G: Well, now look, of course we're going to show here up to March thirty-first our estimates. Well now, if this is confined to income tax it's fine. -

HMjr: Well, that's what my suggestion was.

G: Yes, that's your suggestion.

HMjr: Popper isn't so dumb.

G: No, you thought of it. All right, all right (Laughter)

HMjr: What?

G: Check (Laughter)

HMjr: No, the whole point is that everybody - first everybody wrote -

G: Yes

HMjr: - that our estimates - that we were going to have at least fifty per cent in excess of what -

G: Yes, yes, yes

HMjr: And when the first story broke that went out.

G: Yes, yes - yes

HMjr: The other smart boys like Paul Mallon - and all the others wrote -

G: Yes

HMjr: - oh, our stuff is way under our estimates.

G: Yes - you saw that, did you? I thought that was pretty - I thought that was pretty good for him to print that that we were disappointed, didn't you?

HMjr: What's that?

G: I thought it was pretty good for him to print that that we were disappointed.

HMjr: Yes -

G: The effect is good.

HMjr: Well, I didn't know about that - I'd much rather be accurate.

G: Yes, well -

HMjr: When I get the statement from Bell, if my memory is right, I think they estimated for March around four hundred and two million.

G: Four hundred and five - I - well, daily statement basis it may have been four hundred and two.

HMjr: Well, I'll split the difference.

G: Yes, yes

HMjr: And we'll give the difference to Mrs. Klotz.

G: All right, yes

HMjr: And - did she smile?

G: Yes, she 'hee hee'd'.

HMjr: What?

G: She 'hee hee'd'.

HMjr: She 'hee hee'd'?

G: Yes

HMjr: All right - and I haven't pulled any April first tricks today.

G: No (Laughter) We were

HMjr: All right, but I thought that this suggestion was kind of cute.

G: Yes - I think it was all right.

HMjr: But the trick is to break it down by States.

G: Yes, yes

HMjr: Then each State will carry it. But the thing is - the reason I am calling now is that it ought to be done fairly fast.

G: Yes, yes - Our thirty-first collection story will come out about the - about the twentieth of April and it would be better to get this out ahead on the daily statement basis which we could easily do because they might -

HMjr: I thought you ought to break it tomorrow.

G: Yes, yes, I think we can do that.

HMjr: I would particularly look up - I would be very much interested - notice what I said, you've got it, for eight months and then one month -

G: Yes - for the first eight months, to March one and then do the same thing - I - I understood, for the nine months up to March thirty-one?

HMjr: No, I want March separate.

G: March separate?

HMjr: And then under these the total.

G: Yes

HMjr: You'd have eight months separate -

G: Yes

HMjr: March separate - and then you'd run the total -

G: Yes, yes

HMjr: It will give you nine months.

G: Yes, yes

HMjr: And that would be on the left hand side of the column - then as you went across you'd break it down by States.

G: Yes, yes

HMjr: And then - the actual on our estimates and then compare it with four previous years.

G: Yes, well, we could probably come out and have the break down by States on the daily statement basis - we could take that break down by States up to March one - no - March one, yes, we have that, you see, up to March one, the break down by States which is on the collection basis. But we won't get the break down by States for March until about the - they won't have it ready until around about the twentieth.

HMjr: Well, that - whatever it is. But the point - this shows that we're within - I figure two to three per cent of our estimates.

G: Yes

HMjr: See?

G: Yes

HMjr: We're just about two or three per cent better.

G: Yes

HMjr: So that when we asked for this money in the new tax bill we knew what we were talking about.

G: Yes, yes

HMjr: I want to get the impression over that when the Treasury estimate they know what they're talking about -

G: Yes

HMjr: We say we need so much more money in the new bill - we know what we're talking about -

G: Yes

HMjr: But I thought the lead on Guy Helvering's story was unfortunate.

G: Yes - the lead that the -

HMjr: That we haven't asked for enough.

G: What?

HMjr: - we haven't asked for enough.

G: Oh - oh, well -

HMjr: Helvering said that this won't produce enough revenue.

G: Oh, well, it won't - what he said was it won't produce as much as we asked for.

HMjr: Oh - well, I didn't get that.

G: Yes, yes

HMjr: Well, I - do you like my idea?

G: I like it fine, yes.

HMjr: I haven't had an idea in a long time.

G: Yes, I think that's fine, yes.

HMjr: All right, now look -

G: Yes

HMjr: Is Mac there?

G: Yes, he is.

HMjr: Please

G: Yes - he's getting on.

Wm.
McReynolds: Yes, Henry

HMjr: Mac -

McR: Yes

HMjr: We'll be using my own car Sunday so let the fellow have off Saturday, will you?

McR: O. K.

HMjr: Is anybody using him?

McR: Well, they use it about once a day.

HMjr: That's all right.

McR: And he wanted to get off today and tomorrow and I sent him to Mrs. Klotz and she let him off. (Laughter)

HMjr: Good

McR: (Laughter) So he's got - he'll have plenty of time off.

HMjr: She's a softie.

McR: (Laughter) All right, we'll see that he is on Sunday.

HMjr: All right.

McR: Listen -

HMjr: Now, what I wanted to talk to you really about was I wanted the three of you to give me the inside story of what is going on in liquor.

HMjr: Is Mrs. Klotz on the phone?

McR: She isn't on the phone, no.

HMjr: Well, where are you sitting, on my chair?

McR: Well, yes, I'm -

HMjr:

McR: Wait just a minute. -- She's on now.

HMjr: Are you there?

H. S. Klotz: Yes, sir

HMjr: Good

McR: What happened was we talked it over this morning and in the Staff Meeting and the rest of us all -

HMjr: Oh, yes

McR: - pressing and Wayne was a little hesitant about doing anything to close it up.

HMjr: Yes

McR: Well, Herman told him that he had instructions from you that it was to be disposed of today.

HMjr: Oh, oh -- that's not quite right.

McR: Well -

H.S.K.: That's what he said.

HMjr: What?

H.S.K.: That's what he said.

HMjr: No, I didn't say any such thing.

McR: Well, anyhow, I think it was a good effect -

H.S.K.: Yes

McR: - to get it going.

HMjr: Well, he didn't - Taylor didn't think I was going over his head?

McR: No, no, I don't think so. I don't think he got that impression.

HMjr: No

McR: But here, the darn conferences are no good.

HMjr: What's that?

McR: I say, the conferences are no good.

HMjr: Yes

McR: They haven't gotten any place. I told you yesterday. Now, what we have - Graves has written a letter to the Secretary of State -

HMjr: Yes

McR: Do you want to listen to it?

HMjr: No

H.S.K.: It's a long -

HMjr: If you want to you can put it on the radio.

H.S.K.:

HMjr: I don't - I don't think I'll need it, do you, Mrs. Klotz?

McR: Well, there's this -

H.S.K.: No -

McR: unless you have given it prior approval.

HMjr: We've got this whole radio system - radio it to me.

McR: Yes

HMjr: Hello?

McR: Yes, well, why not - why wouldn't it be better - let you get it in the pouch in the morning?

HMjr: That's all right.

McR: And then you can read it and we won't have any trouble about quoting.

HMjr: People don't have any confidence in Coast Guard -
that's the trouble.

McR: I know, but - it will take -

H.S.K.: He certainly don't.

McR: - It will take them until tomorrow to get it coded,
you know.

HMjr: Oh -

H.S.K.: - Take until next -

HMjr: wants to send it by air mail to Jackson-
ville

H.S.K.: (Laughter)

McR: (Laughter)

H.S.K.: (Laughter) Oh, it's lovely -

McR: (Laughter)

H.S.K.: You know, Oliphant was furious at Taylor today.

HMjr: Why?

H.S.K.: Well, because Taylor called upon Ely Frank to discuss
the legislation and Ely Frank wasn't prepared and he
looked like a monkey.

HMjr: Who did?

H.S.K.: Ely Frank

HMjr: Yes

H.S.K.: And so did we all.

McR: - Well, the trouble was that Ely and the other boys
didn't understand that they were going in to talk
about the - either the policy or the merits of
the legislation.

HMjr: I see.

McR: They were going to talk about this one question that
has been raised.

HMjr: Yes

McR: Well, that had been disposed of.

HMjr: When did he call on Ely Frank?

McR: At the final conference yesterday -

HMjr: Oh -

McR: - with the State Department people and the Canadian people and -

HMjr: I see.

McR: - everybody there. In other words he put himself over on the side of the other people for the minute.

HMjr: Yes

McR: Which wasn't so good. Of course this letter merely undertakes to inform the State Department - the last paragraph is, 'Inasmuch as the Canadian representatives have failed completely to meet the point made by the President in his telegram of March twenty-three - '

HMjr: Yes

McR: '.....this Department is compelled to advise you...'

HMjr: Yes

McR: '.....that it has no recourse other than to request the Senate Finance Committee to proceed with its consideration of the legislation'.

HMjr: Sounds all right to me.

McR: I think the letter is perfect, as far as I can see.

HMjr: Don't let him read the whole letter, Mrs. Klotz, though, you know he's -

H.S.K.: (Laughter)

McR: (Laughter) I'm not going to.

H.S.K.: In fact, I want to say this, in fairness to Taylor, if you want - just to take a minute. -

HMjr: Please -

H.S.K.: After all, Oliphant and Hester and that group worked on

the legislation.

HMjr: Right

H.S.K.: The man wasn't prepared. Oliphant, I feel, should have been, if they were going to have the meeting at all and they were going to discuss the policy of the legislation and all Oliphant should have been there.

HMjr: Right

H.S.K.: It was very unfair to Taylor.

HMjr: Yes

H.S.K.: He just stumbled all over and I mean, there was the State Department on the side of the liquor people, there was the Canadian Government on their side and our three people, Ely Frank, Mr. Graves, who never opened his mouth once at yesterday's meeting at the closing - !

HMjr: Yes

H.S.K.: - we - they looked - it was terrible!

HMjr: Yes

H.S.K.: You wondered why I was so upset yesterday, I was sick, really!

HMjr: Yes

H.S.K.: They were the smartest bunch of men I've ever met!

HMjr: Oh, yes

H.S.K.: They were really the brightest attorneys - these fellows can get the cream.

McR: Oh, she just fell for them, that was all.

H.S.K.: Oh (Laughter) McReynolds said I just fell for all the men.

HMjr: Oh -

H.S.K.: No - they, I mean, oh, it was -

HMjr: Were they all Canadians?

H.S.K.: Yes, I think so, yes -

HMjr: Well, I don't understand why Oliphant wasn't there, Hester -

H.S.K.: Well, Oliphant said he wasn't there because he had no idea that that was going to be discussed.

HMjr: Oh -

H.S.K.: He didn't want it discussed. He said he'd kept away from them for a year - didn't want to meet them - you didn't want to meet them -

HMjr: Well, the way the matter stands now, I get this letter in the pouch?

H.S.K.: Right

McR: That's right.

HMjr: And then I'm to read it and then call in the morning, is that the idea?

McR: That's right - he'll tell us what -

HMjr: All right

McR: He'll tell us what to do with it after you read it.

HMjr: I will.

McR: O. K.

HMjr: I tell you what you might do, you might think this over - whether it should be in such form that I should sign it in case Taylor doesn't want to.

McR: Well, I thought we'd send the original down.

HMjr: Yes

McR: And if you decide that you want to sign it - it's prepared for your signature.

HMjr: Yes

McR: You can sign it and send it on back.

HMjr: I don't want to do anything to hurt his feelings.

McR: Well -

H.S.K.: Well, I think, since you were out of the whole picture, really, I mean -

HMjr: me to sign it down here as the only document is an awful slap to Taylor.

H.S.K.: I think so.

HMjr: I -

H.S.K.: I think so.

McR: I think -

HMjr: I think that he ought to be given his chance, then if he objects and I still say I want him to sign it he should be a good soldier and sign it.

H.S.K.: I think he will, too.

HMjr: Yes

McR: I don't think there is any doubt about it.

HMjr: No

HMjr: Now, I - when I get back I'm going to have a heart to heart talk with a couple of people that were there because I don't understand why it was handled the way it was.

H.S.K.: I don't either.

HMjr: But I'm not at all upset about it and I can wait until I get back.

H.S.K.: That's fine.

HMjr: I'm not at all upset, but it certainly was - I don't understand it.

H.S.K.: Well, as far as Oliphant fe - goes, I mean his feeling is the meeting could just as well not have taken place. He's going right ahead with it anyway.

HMjr: I see. - All right, what else?

H.S.K.: That's all - nothing new has happened outside of - Canadian liquor.

HMjr: Pardon me?

H.S.K.: Nothing new -

HMjr: Well - how's the weather up there?

H.S.K.: Oh, it's lovely, it's cold but it's lovely.

HMjr: Yes, well, I doubt if I'll call again.

H.S.K.: All right, sir. Well, we'll hear from you in the morning.

HMjr: Pardon me?

H.S.K.: We'll hear from you in the morning.

HMjr: Yes, mam.

H.S.K.: All right.

HMjr: Goodbye.

H.S.K.: Goodbye.

McR: Bybye.

1 April, 1936

From: Spagent, Shanghai, China.
To: Assistant Secretary Taylor.

Message from Professor Buck: Reported your inquiry March 28th last evening to Kung. His first reaction was as follows: "There is a grain of truth in the rumor. It is difficult to consummate transactions with America." He explained further "Ross stay was prolonged partly account Hu Kwang Railway and also probably larger British economic interests in China especially since Cadogan is leaving. Ross has insisted regularizing all old loans before giving consideration to new loans. He may have said (but I do not know) when this is accomplished Britain is ready to make new loans either through the old consortium or a new group or even alone if United States and others do not want to participate. There is nothing in offer to bondholders to adversely affect America's participation future financing railway. We want America's help and would like to know whether or not she is willing to participate. Britain especially interested in Sze Chuen Railway. Very confidential, and I have told no one, we want a back door by rail to British Burma so as to cope with Japanese aggression from Pacific. Also anxious to make loan on railway development.

Last winter United States reply was for China to consult other powers about a loan. As a step in the process United States was asked to send a representative but did not do so as England did.

Secret information today that heavy artillery is being moved into eastern Hopei by Japanese to oust Sung Cheh Yuan who is not submitting to Japanese and replace with Wu Kung who has Japanese wife and is pro-Japanese. Japan also pressing to assist in suppression Reds in Shan Si. She will attempt to take North China. Sung Cheh Yuan has a strong Chinese Government and will fight if pressed too far. China is making all possible preparation for armed conflict with Japan and it may not be localized to North China. If other countries do not attack the bandits (pro-Japanese) now, the bandits will attack them later and Japan will be in a much

Note: Remaining sections of this message to follow.

C O P Y

April 2, 1936.

From: Spagent, Shanghai, China.

To: The Secretary of the Treasury.

(Continuation of message of April 1 from Professor Buck.)

.....stronger position after gaining control of China's natural resources and man power. A firm stand by United States and by other countries will aid China greatly.

Please inform Morgenthau and ask him to tell other important officials interested in China that China is in great need of further financial support and publicly announced support as in case of Secretary's statement on success of monetary policy which helped tremendously and is greatly appreciated.

Desire United States buy more silver at prices advantageous to China. I am determined to firmly establish new monetary system as stabilizing influence in China. For this, larger stabilization fund needed.

Earnestly request Secretary support lengthening period of payment of wheat loan and any other adjustment regarding this loan as brought to Secretary's attention by Department of State.

Please ask Secretary to extend my greetings to his parents."

This Sino-Japanese situation needs immediate well considered action.

I have not met Leith Ross, and had expected he would ask to see me in some way similar to my meeting Young in Hongkong. I have made no effort to see or to avoid him.

DEPARTMENT OF STATE

Washington

April 2, 1936.

My dear Mr. Secretary:

From time to time, proposed actions under the provisions of Section 303 of the Tariff Act of 1930 are referred by the Department of the Treasury to this Department for the comment of the Executive Committee on Commercial Policy. This is in accord with the Executive Order establishing the Committee as a coordinating and clearing body for all matters relating to our foreign trade.

Some of the countervailing duty cases so referred have grown out of practices by foreign governments involving special currency controls of one kind or another. In these cases the Committee has not always been clear as to the legal and policy aspects presented. On March 6, 1936, it accordingly appointed a subcommittee to study the question of countervailing duties in respect to currency problems, in order that the Executive Committee on Commercial Policy might arrive at a clarified position on which to base its comments. The subcommittee has now submitted its report. This report was considered by the Executive Committee on Commercial Policy at its meeting of March 31, 1936. Discussion of the report and of its conclusions was followed by the unanimous adoption of the following resolution, with the Treasury representative not voting:

"The Executive Committee on Commercial Policy adopts the report of March 28, 1936, of the Subcommittee on Countervailing Duties and recommends to the Secretary of State that he urge its earnest consideration by the Secretary of the Treasury in deciding upon the Treasury Department's course of action under Section 303 of the Tariff Act of 1930 with respect to Hungary, Latvia, Germany, and other countries practicing currency manipulation."

I am pleased to comply with this recommendation and accordingly I attach for your consideration a copy of the report of the subcommittee, as approved by the Executive Committee on Commercial Policy.

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From the standpoint of economic policy it seems entirely clear that the application of countervailing duties in cases arising out of currency controls cannot fail to have deplorable repercussions upon our foreign trade. Particularly is this true with respect to those countries such as Germany in which a large part of our imports would be affected or potentially affected by countervailing duties if the view were to prevail that Section 303 does require this action.

Such action with respect to Germany would mean not only that we would sustain a further and drastic loss of markets in that country for our agricultural and other raw material surpluses, but that any hope of reestablishing our trade relations with that country on a normal basis would be greatly prejudiced for some time to come. This would be particularly unfortunate at the present time, because in a very recent communication to this Department the German Government has indicated, for the first time, its readiness to go a long way in meeting our insistence on non-discriminatory treatment of American commerce in Germany. It would be most regrettable if our conversations with Germany in this vital matter were to be brought to an end, as they unquestionably would be if the penalties of Section 303 were imposed upon our imports from Germany.

I fully recognize the mandatory nature of Section 303, once it is determined by the Secretary of the Treasury that a bounty or grant is, in fact, bestowed upon the production or exportation of articles shipped to the United States. However, I am in agreement with the view presented in the subcommittee's report that there is considerable doubt whether currency manipulations fall within the meaning of the term "bounty or grant" as used in Section 303, and whether they may not more appropriately be regarded as a special form of currency depreciation.

That such reasonable doubt exists is strongly evidenced by the fact that in the first and second Sessions of the 72d Congress (1932, 1933), several bills were introduced, having for their purpose the imposition of additional duties to compensate for the depreciation of foreign currencies. Hearings were held on this subject at both sessions, but none of the bills was reported out of Committee. Neither in the testimony of representatives of the Treasury Department and of the Tariff Commission nor in the debate on the floor of the House on a motion to discharge the Committee from further consideration of one of these bills was there any reference to Section 303 as affording a basis for the type of action which was contemplated in the bills then pending. On the contrary, the interpretation apparently accepted by all seems to have been that Section 303, which at that time had been on the statute books for two or more years, was not intended to be applicable in cases of currency depreciation.

-3-

In transmitting to you the report adopted by the Executive Committee on Commercial Policy and in adding these comments of my own, I am sure that you will understand that I have no desire in any way to encroach upon the performance of a mandatory duty imposed upon you by law. My only desire is to be of any assistance that I may in the study of the appropriate scope of this measure which has so direct and vital a bearing upon the broader aspects of our whole commercial policy.

Sincerely yours,

(Signed) Cordell Hull.

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

April 2, 1936

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My dear Mr. Secretary:

On Monday and Tuesday, March 30 and 31, in accordance with our understanding with you, conferences were held in the Treasury for the purpose of determining whether, within the scope of the President's telegram of March 23 to Under Secretary Phillips, it would be possible to find a satisfactory course of action which would eliminate the necessity for the legislation contained in H. R. 9185, imposing certain restrictions upon the importation of liquor into the United States. There were present at the conferences attorneys for three Canadian companies, Hiram Walker, Seagram's, and Canadian Industrial Alcohol, the Canadian Charge, Mr. Hume Wrong, and representatives of the State and Treasury Departments.

It was made clear that the object of the conversations was to ascertain whether the companies involved could give some practical assurance in connection with the prosecution of the Government's claims against them, that, in the absence of legislation, they would submit to the jurisdiction of the United States Courts and pay any judgments which might be obtained. Latitude was given the Canadian representatives for the discussion of other aspects of the questions raised by the pending legislation, but it was emphasized that if the Treasury Department was to be expected to withdraw its request for legislation it would be necessary for it to have practical assurances that the objectives of the legislation could be otherwise obtained.

I regret to advise you that the Canadian representatives were unable to suggest any assurances within the scope of the President's instruction. The counsel for the companies canvassed this question at length with the Department's representatives, pointing out the difficulties which they felt they would encounter in giving assurances along the lines desired. Their response to the Department's invitation for a concrete suggestion was that, pending a satisfactory settlement of any outstanding claims, their companies would refrain from accelerating the rate of their shipments of whiskey into the United States and from exporting whiskey to other countries, would maintain their present corporate structures unchanged, and, within the next thirty days, would individually enter into discussions with the proper officials of this Government with respect to these claims. They did not, however, indicate a willingness to enter into an arrangement whereby their principals would submit voluntarily to the jurisdiction of the United States Courts with respect to the claims against them and provide for the satisfaction of such claims after judgment.

Under these circumstances, I must advise you that the Department is compelled to request the Senate Finance Committee to proceed with its consideration of the legislation. It will be appreciated if you will advise the representatives of the Canadian Government accordingly.

Yours very truly,

/S/ Wayne C. Taylor

Acting Secretary

The Honorable,

(sent over 2:30 p. m.)

The Secretary of State.

Thursday
April 2, 1936

Wm.

McReynolds: Didn't you get it over the phone?

HMjr: No

McR: You mean you didn't get it in the pouch?

HMjr: The pouch hasn't come.

McR: Oh, it hasn't come? Well, we'll have it in just a minute.

HMjr: Well, may I ask this while I'm waiting. Is everybody in agreement on it?

McR: No - Mr. Taylor tells me that he thinks there ought to be some softening here and there on it.

HMjr: Yes - who is in the room, please?

McR: Taylor, Gaston, Oliphant, Gibbons, Graves -

HMjr: Yes

McR: And Mrs. Klotz and myself.

HMjr: All right and is the letter on the way?

McR: It's here - I have it here.

HMjr: Oh -

McR: Do you want Mrs. Klotz to read it to you?

HMjr: Yes, please.

H.S.K.: Hello

HMjr: Hello

H.S.K.: Isn't he a 'meanie'?

HMjr: What's that?

H.S.K.: (Not spoken to the Secretary) I think you'll have to hang up because you -

HMjr: Hello

H.S.K.: Hello

HMjr: Yes

H.S.K.: 'On Monday and Tuesday, March thirty and thirty-one in accordance with our understanding with you...' - can you hear me?

HMjr: Yes

H.S.K.: '.....conferences were held in the Treasury for the purpose of determining whether within the scope of the President's telegram of March twenty-three to Under-Secretary Phillips.....'

HMjr: Yes

H.S.K.: '.....it would be possible to find a satisfactory substitute for the legislation contained in H. R. 9185 imposing certain restrictions upon the importation of liquor into the United States. There are present at the conferences attorneys for three Canadian companies, Hiram Walker, Seagrams, Canadian Industrial Alcohol, the Canadian Charge, Wrong, the representative of the State and Treasury Departments.

'It was made clear that the scope of the conversations was to be limited to the question, 'Whether the companies involved could give some practical assurance in connection with the prosecution of the Government's claim against them, that, in the absence of legislation they would submit to the jurisdiction of the United States Courts and pay any judgments which might be obtained'. Latitude was given the Canadian representatives - '

HMjr: Pardon me, I didn't get that.

H.S.K.: 'Latitude...'

HMjr: Yes

H.S.K.: '....was given the Canadian representatives for the discussion of other aspects of the questions raised by the pending legislation. But the point was emphasized that if the Treasury Department was to be expected to withdraw its request for legislation it would be necessary for it to have practical assurance that the objectives of the legislation could be otherwise obtained.

'In the course of the discussions the only assurances which any of the Canadian representatives suggested, and these, it should be said, were subject to confirmation by their principals, were that,

pending a satisfactory settlement of any outstanding claims they would refrain from accelerating the rate of their shipments of whiskey into the United States and from exporting whiskey to other countries; would maintain their present corporate structures unchanged and within the next thirty days would individually enter into discussion with the proper officials of this Government with regard to these claims.

'Much was said by the Cana - ' Hello?

HMjr: Hello -

H.S.K.: Someone just lifted the receiver.

HMjr: Hello -

H.S.K.: 'Much was said by the Canadian representatives in opposition to the proposed legislation, both in respect to its probably effect on the relations between Canada and the United States and in respect to its practical results on the importation of Canadian whiskey into the United States. But the Canadian representatives indicated no willingness to submit voluntarily to the jurisdiction of the United States Courts with respect to the claims against them or to give assurances for the satisfaction of such claims after judgment' -

HMjr: Yes - is that all?

H.S.K.: No, one more paragraph.

'Inasmuch as the Canadian representatives have failed completely to meet the points made by the President in his telegram of March twenty-three this Department is compelled to advise you that it has no recourse other than to request the State Finance Committee to proceed with its consideration of the legislation. It will be appreciated if you will advise the representatives of the Canadian Government accordingly.'

HMjr: Is that all?

H.S.K.: Yes

HMjr: Hello?

H.S.K.: That's all.

HMjr: You ought to have a drink of water now.

H.S.K.: (Laughter)

HMjr: After reading all of that. Well, now, I'd like to - who wants to speak?

H.S.K.: Who wants to speak?

HMjr: Don't they usually have the opposition speak first?

H.S.K.: I think so. (Laughter) Mr. Taylor -

HMjr: Hello?

W. C. Taylor: Hello

HMjr: Hello

T: Yes

HMjr: What's the matter with the letter, Wayne?

T: I don't think the tone of it is right.

HMjr: Well, what's the matter with it?

T: I think it ought to be, as I say - I told you over the telephone it ought to be that of a parent reluctantly beating his child rather than one who is getting a little fun out of it. It had the same effect, if you do it that way.

HMjr: I don't - I don't remember your saying that, you may have, but -

T: Yes, well, I guess I wrote it to you in my pouch.

HMjr: That's the trouble - I haven't got my mail.

T: Yes, that's it. For instance, when we say that - down in paragraph three, '....the only assurances...' and so and so -

HMjr: Yes

T: And the paragraph following that - why, we talk a little too much, as if these boys came down here and just went through the motions. Now, that may be true but I don't think it helps any.

HMjr: Well, of course, this isn't the letter we're writing to them. This is the letter we're writing to the State Department.

T: Well, I think even so.

HMjr: Of course, it's terribly difficult for me to pass on a thing when I wasn't at the conferences.

T: Well, my point is that we look better as far as getting the State Department to go to bat for us if we - at least pretend and I think it isn't necessary to say that we pretended it - that we did everything that we could to listen to what the Canadians suggested, but that it just didn't work and that we weren't good enough.

HMjr: Well, now - do you mind - let me have Graves on?

T: Yes

HMjr: Who - who I might say has the liquor enforcement angle.

T: Right

HMjr: Hello

Harold Graves: Hello, Mr. Secretary.

HMjr: Yes, Harold - how do you feel about the letter?

G: Well, I can say this with respect to what Mr. Taylor has said, that I think it would be very easy to modify the letter to meet the points which he has raised without in the least weakening our position.

HMjr: Without weakening it?

G: Yes, sir

HMjr: Well, if you could do that - after all he's got to sign it, I don't.

G: Yes

HMjr: What?

G: I can - I think we can very quickly and very readily, modify the letter to meet the suggestions which have been made by Mr. Taylor.

HMjr: Well, now, may I talk to Mr. Oliphant, please?

G: Yes, Indeed.

Herman Oliphant: Hello -

HMjr: Hello, Herman

O: Yes

HMjr: I'm trying to hurry so not to tie you up.

O: Well, that's all right.

HMjr: Herman, why don't we do this - let Taylor and Harold Graves see if they can't modify it. When do you come back off the Hill?

O: Yes

HMjr: What time?

O: Well, I'll be back here at twelve-thirty.

HMjr: Let them have the letter ready at twelve-thirty.

O: Yes

HMjr: You sit in with the two of them -

O: Yes

HMjr: And you make sure that by modifying if we don't in any way jeopardize our legal position, see?

O: Right

HMjr: And then if the three of you are satisfied, let her go.

O: All right.

HMjr: If the three of you aren't satisfied why I'll talk to you some time between three and four.

O: That's fine.

HMjr: How does that strike you?

O: That's good.

HMjr: What?

O: That's good - that's a good way to handle it.

HMjr: Because, Harold's kind of a tough baby - I saw the 'March of Time' last night -

O: Yes

HMjr: And I saw Harold in it for the first time. Gosh, he scared the life out of me!

H.S.K.: (Laughter)

O: (Laughter) Wonderful voice, isn't it?

HMjr: And those eyes!

O: (Laughter)

HMjr: Gosh, when he looks at me! - No wonder they - I - I didn't even speak in the movie. I was flabbergasted.

O: No wonder we're licking the bootlegging problem, eh?

HMjr: Gosh!

O: (Laughter)

HMjr: And -

O: Is he red in the face?

HMjr: What?

O: Is he red in the face?

HMjr: I don't hear you.

O: I say, is he red in the face (Laughter)

HMjr: Well, that's - let me ask - just talk to Wayne again, then let me ask if that's agreeable to him.

O: All right

HMjr: Hello -

Taylor: Yes, perfectly.

HMjr: All right, well then, you and Graves work together and have a letter ready at twelve-thirty. At twelve-thirty the three of you sit down.

T: All right.

HMjr: If you're in complete accord - the letter goes over at one o'clock.

T: Right

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HMjr: If you're not I'll talk to you at three or four.
Is everybody happy?

T: Yes

HMjr: Entirely?

T: Yes

HMjr: McReynolds satisfied?

T: Says he is.

HMjr: He is?

T: It's raining, otherwise no complaints.

HMjr: What?

T: It's raining hard, otherwise no complaints. (Laughter)

HMjr: I don't hear you.

T: It's raining hard.

HMjr: And that interferes with his golf?

T: Yes

HMjr: I know - it'll be tough on him next week he'll have to
work again.

T: Steve wants to talk to you a minute.

HMjr: All right - Well, then - tell Herman that's all I
want from him now.

T: O. K.

Steven
Gibbons: Hello -

HMjr: Hello -

G: How are you?

HMjr: I'm getting strong -

G: Say, am I laughing! I've been sitting with this thing
for two years and these boys have been trying for two
days to straighten out.

HMjr: Yes

G: You know, every racketeer in the world has been in and talked liquor to Ely Frank and I -(Laughter) -

HMjr: Yes

G: I think Herman's getting - gotten twice as gray in the last four days -

HMjr: What's that?

G: Herman's gotten twice as gray in the last four days.

HMjr: Herman's gotten gray?

G: Yes (Laughter)

HMjr: He doesn't sound gray.

G: (Laughter)

HMjr: Sounds full of pep to me.

G: (Laughter) How's the weather?

HMjr: It's fairly good.

G: And how is Mrs. Morgenthau?

HMjr: She's getting along nicely, thank you.

G: All right, glad to hear from you.

HMjr: How are all the politicians?

G: Why, I think they're all satisfied. They - they're all sure that we're going to win in a big way, you know, and - so they have nothing to kick about now.

HMjr: Yes - Now on this liquor thing,- is everybody together?

G: Everybody over here, I think, and over in the State Department of course -

HMjr: No, I mean in my room there.

G: Yes, yes, everybody is together this morning.

HMjr: All right.

G: Wait a minute, I think Herbert wants to talk to you. Goodbye.

HMjr: Goodbye.

Herbert E.

Gaston: I thought you might be interested in a Housing meeting that I attended yesterday afternoon.

HMjr: Oh, yes

HEG: They had a half a dozen members of the House of Representatives there and -

HMjr: Where was it held?

HEG: It was held over at the National Emergency Council.

HMjr: Yes

HEG: Ickes presided. The interesting thing about it is that Peter Grimm's idea that he had gotten to a substantial agreement with Wagner is apparently all out the window because Ellenbogen announced that he and Wagner were going to introduce today an identical bill - it's for the creation of the United States Housing Authority for purpose of slum clearance and low cost housing, and it takes in the Division of Housing of PWA. And it's got everything in it including the kitchen sink. That is it - it gives them the authority to make grants up to forty-five per cent for - it has big annual appropriations starting at a hundred million. It has authority to issue wholly guaranteed bonds and they can go up to forty-five per cent in grants for construction and they can pay subsidies after it. They can do just about anything they feel like.

HMjr: Well, give them all a copy of Wesley Stout's article in this week's Saturday Evening Post.

HEG: Yes (Laughter)

HMjr: I can't worry about that -

HEG: I don't think so, but I thought you might be interested in what's happening.

HMjr: Well, Herbert, it's hard for me over the phone.

HEG: Yes

HMjr: Would you drop me a line about it?

HEG: Yes, I will.

HMjr: Yes

HEG: Also, Alverson has asked - has telegraphed to McIntyre to get permission to circulate copies of Peter Grimm's

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report to the President.

HMjr: Well, get him to include a copy of Wesley Stout's article.

HEG: Yes, all right, I'll try to do that.

HMjr: O. K.

HEG: income tax figures for March in today -

HMjr: Yes

HEG: They're telegraphic reports and I think we'll have a pretty complete story to give out.

HMjr: Good --- by States?

HEG: By States, yes. Collections for March and for the last

HMjr: Yes, yes -

HEG: All right.

HMjr: Mrs. Klotz

HEG: She's on.

H.S.K.: Hello -

HMjr: Hello

H.S.K.: Yes

HMjr: Mrs. Klotz -

H.S.K.: Yes

HMjr: Do you want to go over that mail with me?

H.S.K.: That I have in my room?

HMjr: Please

H.S.K.: Yes, I will. All right.



DEPARTMENT OF STATE
WASHINGTON

April 3, 1936

My dear Mr. Secretary:

I refer to conversations which have been in progress for some time between officials of your Department and of this Department in regard to Section 403 [402] of H.R. 9185, which is now pending before the Senate Finance Committee. I refer in particular to Mr. Taylor's letter of April 2nd, which dealt with the conversations on Monday and Tuesday with representatives of the Canadian distillers and the Canadian Chargé d'Affaires.

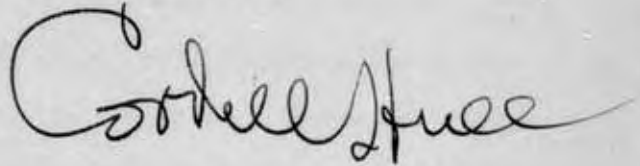
I now enclose a copy of a telegram dated April 2nd, to the President in connection with this whole question and a copy of the President's reply, dated April 3rd, which has just been received. You will note that the President considers it advisable that some form of temporary settlement along the lines of the telegram to him be reached, and he expresses the hope that the

The Honorable
Henry Morgenthau, Jr.,
Secretary of the Treasury.

State and Treasury Departments can agree on a formula. He adds that if no such formula can be arranged, that the whole matter should be held in abeyance until he returns.

This Department holds itself in readiness to confer with officials of your Department in accordance with the President's instructions.

Sincerely yours,

A handwritten signature in cursive script, reading "Cordell Hull". The signature is written in dark ink and is positioned to the right of the typed name "Cordell Hull".

Enclosures:

To the President
April 2, 1936;
From the President,
April 3, 1936.

LMS

April 2, 1936

THE PRESIDENT,

AT SEA.

4.

RESTRICTED.

In your telegram to Mr. Phillips from Miami, dated March 23, respecting the proposed legislation to embargo the importation of liquor from Canada to the United States except on certain conditions, it was stated QUOTE If the companies can give some practical assurance that they will come into court, and that any judgment which may be obtained against them will be paid, no legislation is necessary at this time UNQUOTE. Upon this being communicated to Prime Minister King, he urged the companies to confer here with the Treasury Department. Accordingly, last Monday the representatives of the companies, along with the Canadian Charge, called at the Treasury to confer with Assistant Secretary Taylor and some of his subordinates. This Department was represented at the conference by Moore, Hackworth and Hickerson.

At the outset the Charge and Mr. Ralston, of the Canadian group, a former member of the Canadian Cabinet and close friend of Mr. King, protested against the legislation as a coercive measure of unprecedented nature

LMS 2-No. 4 to The President, At Sea.

nature and calculated to work injustice and a disturbance of friendly relations. Further it was stated by the Canadians that the Treasury had made no effort to settle the claims, and negotiations in that direction were suggested, but the suggestion was declined by the Treasury. Then the Canadians considered their readiness to give some such QUOTE practical assurance UNQUOTE as specified in your telegram to Mr. Phillips, but said it was obviously impossible to speak definitely on that point without knowing the amount of the claims, so as to know what might be the QUOTE practical assurance UNQUOTE in the way of cash deposits or bonds. They stressed knowledge of the amount of the claims as an important and determining factor.

I believe that you already understand the Treasury position and so I will not undertake to recite it in detail. The Treasury officials stated their indisposition to indicate the amount of the claims and defended the proposed legislation as being merely additional measures to facilitate the collection of proper claims. Since the Canadian representatives insisted they could not discuss QUOTE practical assurances UNQUOTE to submit to our jurisdiction until they knew the amount and nature of the claims and the Treasury

Department

LMS 3-No. 4 to The President, At Sea.

Department was not in the position to indicate the amounts of the claims, the conferences were devoid of results in the matter of defining QUOTE practical assurances UNQUOTE.

The representatives of the State Department repeatedly urged the Canadians to do their utmost to meet the President's proposals. Before leaving Washington Tuesday night the representatives of the Canadian companies made substantially the following proposals and comments:

(1) The Treasury Department would agree to drop the entire embargo section for QUOTE a month or six weeks at least UNQUOTE, and if at all possible until next January, with the understanding that if after full and frank negotiations they could not obtain satisfactory settlements or commitments from the Canadian companies the legislation be then enacted.

(2) The Canadian distillers would give commitments not to increase their exports of whiskey to the United States over the present volume, making some allowance for normal increase in business. Thus, by next January, only 10 to 20 per cent of the present stocks of whiskey would be sold and there would thus be an ample quantity of whiskey against which the Treasury Department could proceed if necessary.

(3) The Canadian distillers would give commitments not to dispose of their stocks of American type whiskey elsewhere.

(4) The individual companies would give commitments to QUOTE sit down with Treasury officials and discuss the nature and quantum of the claims alleged to exist with a view to reaching some solution UNQUOTE. (We understand this proposal to mean

(a) reaching

LMS 4-No. 4 to The President, At Sea.

(a) reaching an amicable settlement out of court or, failing this, (b) discussing terms, conditions and practical measures in respect to their submitting to our jurisdiction and protecting the United States against losses on judgments which might be obtained.)

(5) They said that, if the legislation is enacted, the amount of security which the companies would be required to provide would make it impossible for them to export the liquor and hence to submit to the jurisdiction of the courts; that on the sixteen million gallons intended for export to the United States, this Government would lose forty million dollars in import duties, not to mention losses on excise taxes.

The Charge d'Affaires said that the Canadian Government is prepared to use its good offices insofar as possible to insure compliance on the part of its nationals with these proposals and to do everything it can to facilitate further conferences. Mr. Wrong stated in effect that if after trying the above-mentioned procedure the Treasury Department should finally become convinced that the proposed legislation is required, he felt certain that his Government, while objecting to the principles of the legislation, could not interpose serious objection to its enactment in view of the efforts which would have been made in response to its urgent representations to settle the matter without such legislation.

The Treasury Department has informed me this afternoon that it considers the procedure suggested by the

Canadians

LMS 5-No. 4 to The President, At Sea.

Canadians as unsatisfactory and that accordingly it will request the Senate Finance Committee to proceed with its consideration of the embargo legislation.

With all deference to the views of the Treasury Department in this matter, it would seem to me that the above-mentioned proposals offer a sufficiently feasible plan for solving the matters of difference as to call for further consideration. Rightly or wrongly, the Canadian Government feels that we are proposing to act in an arbitrary and unfair manner and they will feel hurt if their earnest representations have been wholly ineffectual.

The Canadian Charge d'Affaires has again requested that the proposed legislation, in any event, be held up until your return to Washington, in order that he may have an opportunity, in accordance with an instruction from the Canadian Prime Minister, to present the views of his Government personally to you.

Will you please advise me of your attitude towards this request, in order that I may inform the Canadian Government.

HULL
(WP)

U WP/AB

At Sea

April 3, 1936

1:05 p. m.

RESTRICTED.

FOR SECRETARY OF STATE FROM THE PRESIDENT.

Suggest you give Morgenthau personally the gist of what you sent me. Tell him from me that some form of temporary settlement similar to your suggestion seems advisable and that I hope State and Treasury can agree on a formula. If no such formula can be arranged ask Treasury and Senate Committee to hold things in abeyance until I get back. We are having fine trip.

Best regards.

COMMITTEE PRINT—UNREVISED

Note.—This print is for the immediate use of the committee
and is subject to correction

E. W. G. HUFFMAN, Clerk.

REVENUE ACT, 1936

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

SEVENTY-FOURTH CONGRESS

SECOND SESSION

APRIL 3, 1936

M. McElvaine
No. 5



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REVENUE ACT, 1938

HEARINGS

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REVENUE ACT, 1936

FRIDAY, APRIL 3, 1936

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D. C.

The CHAIRMAN. The committee will come to order. The first witness on the calendar this morning is Mr. T. W. Taliaferro, of Detroit, Mich.

Will you state your name to the reporter, your residence, and the capacity in which you appear?

STATEMENT OF THOMAS W. TALIAFERRO, DETROIT, MICH., PRESIDENT, HAMMOND STANDISH & CO., DETROIT, MICH.

Mr. TALIAFERRO. My name is Thomas W. Taliaferro, from Detroit, and representing Hammond Standish & Co., of Detroit, packers.

I merely want to state the condition that Hammond Standish & Co. is in. First, I will give you a history of the business.

We started in 1858—76 years ago. The business has been more or less profitable.

Ordinarily, in times of decline, we have lost some money, and in times of advancing prices we have made money, which is the history of the packing business.

We have between five and six hundred employees. Our business is largely devoted to pork, and we rely almost exclusively on livestock produced in Michigan. We do get some from northern Ohio and from northern Indiana.

But we are the only packers in Detroit that are working today and have passed through all the vicissitudes that the packing business has passed through.

Other packers, such as the Sullivan Co., have closed up. And the Parker & Webb Co. has been sold to an outside interest. The Detroit Packing Co. is now in the hands of the Government.

We have a trade that is almost entirely local. We have had quite an export trade because of the Michigan hogs being especially adapted for English meats, but because of the quota and other restrictions imposed by the British Government we are entirely out of that outlet.

We have had in previous years a very satisfactory trade in Canada for such products as were not easily salable locally in Detroit. But that has been cut off because of the tariff.

So we are now confined to the local trade, and pork is about 90 percent of our business. We have some little business in beef, lamb, and calves, but the main item is pork.

The tax has been an insurmountable proposition to us because of competing meats and other competing products, and the people have turned to those substitutes, and that has cut down our volume of business and made it impossible for us to market our products on a profitable basis.

Our concern has lost money very heavily since this A. A. A. tax was imposed. It added so much to our overhead and expense of doing business. We figured that our overhead and all other expenses were in the neighborhood of \$2.50 per hog, taking all departments together. The tax raised that to about \$7.50 per hog, which is an impossible obstacle for us to overcome.

We have always gotten all we could for meat on a strictly competitive basis, but we could not advance our selling prices to cover the additional expense that was added for doing business.

The big packers, or the national packers we may call them, were differently situated from us in the fact that they had so many different articles that they could draw their profits from. They had beef, lamb, calves, hides, and many byproducts, poultry and eggs, and such products as were favorably thought of by the consumer because he had been educated to the high price of pork, and had had it so impressed on his mind that he naturally showed an antagonism to pork, and he would buy anything else but pork.

Our products are all perishable, and we pay cash for everything we buy. We sell everything for cash, so far as we can, and that takes a lot of money.

Our farmers in Michigan, have gotten into the habit of bringing us their stock direct, as a matter of economy to them, and without this packing house in Detroit, it would be a very great hardship to the farmers in that section of the country if we were not there. They would have to sell their livestock at distant points, and that would add much to their expense and much to their discomfort.

We have had money enough at all times to run our business as it is organized. We have to carry a certain amount of products from the producing season to the consuming season, which is usually from 4 to 6 months. That product takes money to carry it.

We have, at all times, been able to feed in the time of light receipts, but in this instance we were not able to do that because as soon as we got in \$50,000 or \$100,000, the Government came and took it away from us. So we had no money to operate on, and it cut our production down so much that we could not operate in a satisfactory manner, or in any manner that would enable us to overcome the handicaps of the processing tax, which, in theory, might be all right, but in practice it is absolutely wrong, because you cannot force a man to buy a product unless he has the money and the will to do so.

So we were up against the antagonism of the consumer as to this advance in the products, and we were forced to sell our meats almost immediately upon slaughtering.

We take everything that comes to us in the way of livestock. We give the farmers a market for their livestock, but we have no market. That is governed by the will of the buyers and the competition from the outside. We cannot produce our products in competition if we have to go far away for our raw material. The freight rates are so high that a packer from the Middle West can ship his products to

Detroit at the same price as we would pay if we went through the West and bought the hogs, except that we would have had a 30-percent loss, because we pay for the weight of the livestock and he pays on the dressed livestock; and there is about a 30-percent difference, which makes it impossible for us to buy livestock in the West and compete with those who are shipping dressed meat to Detroit.

The CHAIRMAN. How did the processing tax change that situation? You had that same competition, did you not, before the processing tax was imposed? The freight rate did not change what you paid for getting your livestock in there.

Mr. TALLAFERRO. No.

The CHAIRMAN. I cannot see why you did not have that same competition in that same way before the processing tax was imposed.

Mr. TALLAFERRO. We had a local production which was almost eliminated when our pigs and breeding stock were killed off at the initiation of the act. That reduced our local receipts so much that it would force us to go out and buy this livestock, with the handicap I have mentioned.

In addition to that there was the expense of doing business which was increased so much.

The CHAIRMAN. That seems to have been more on account of the drought than anything else, was it not?

Mr. TALLAFERRO. That really was the deciding factor.

The CHAIRMAN. I would think so.

Mr. TALLAFERRO. If the A. A. A. had been carried through without the drought I think it would have been of very much more help to the farmer. But the drought was responsible.

A man raises his hogs only to use up his corn. He raises his hogs first, and then he raises the corn to feed them. He raises his corn for feeding his hogs.

Mr. REED. Let me see if I understand this correctly. I understood you to say you bought some hogs from Michigan, and some from northern Indiana.

Mr. TALLAFERRO. And some from Ohio.

Mr. REED. So is not the question of the processing tax involved in your local market; that is, when the processing tax and the drought came on your supply was more or less limited.

Mr. TALLAFERRO. Yes.

Mr. REED. Then you had to go further west and pay a higher cost than you paid before for the hogs; is that right?

Mr. TALLAFERRO. That is right.

Mr. REED. Then you get the competition of the beef, the mutton, the calves, the poultry and eggs and other substitutes, with the consumers' sales resistance to your products that you want to sell to them; is that right?

Mr. TALLAFERRO. That is quite right. That is perfectly clear; you understand the situation.

Mr. REED. I think you made a wonderfully fine statement.

Mr. TALLAFERRO. I thank you, Mr. Reed. I only wanted to tell you that.

Mr. REED. I assume that the point you wanted to make before the committee was that, according to the way you handle your business, you have to use your undistributed earnings; you need ready cash.

Mr. TALLAFERRO. That is what we have to have; that is a part of the business.

Mr. REED. That is what you came here for, and you want to have the committee be lenient when it comes to the question of a surplus.

Mr. TALLAFERRO. I certainly do.

Mr. LAMNECK. Did you make any money in 1933?

Mr. TALLAFERRO. No, sir.

Mr. LAMNECK. How about 1934?

Mr. TALLAFERRO. I lost money in both years, and in 1935, very heavily.

Mr. LAMNECK. How large an amount of taxes were due to the Government when the A. A. A. went out of business?

Mr. TALLAFERRO. I have that here. I thought perhaps you might ask that question. Shall I give it to you in each year?

Mr. LAMNECK. Just as you please.

Mr. TALLAFERRO. In 1933 the tax was \$45,708.52; in 1934 the tax was \$636,648.23. In 1935 the tax was \$578,443.55. There was an added assessment against us which we got no credit for of \$5,255.16. That makes a total of \$1,252,640.06.

We paid in 1934, \$386,401.97.

Mr. LAMNECK. To the Government?

Mr. TALLAFERRO. To the Government, and that took our working capital.

The net balance of the tax that was not paid by us was \$879,633.09.

Mr. LAMNECK. As I understand it you owed this amount of money, \$879,633.

Mr. TALLAFERRO. Yes.

Mr. LAMNECK. At the time the Supreme Court knocked out the A. A. A.?

Mr. TALLAFERRO. Yes, sir.

Mr. LAMNECK. And the reason you could not pay this was because you were not able to hand down the processing tax to the consumer; is that right?

Mr. TALLAFERRO. Yes, sir. If we could have done that we would have been in the same condition in 1936 as in 1933.

Mr. LAMNECK. What would happen if we should pass this bill and authorize a tax of 90 percent against your concern on this amount of \$879,000? Could you pay it?

Mr. TALLAFERRO. We would close up and liquidate and go out of business.

Mr. McCORMACK. Did you make any money in 1932?

Mr. TALLAFERRO. In 1932—no.

Mr. McCORMACK. Did you make any in 1931?

Mr. TALLAFERRO. No.

Mr. McCORMACK. Did you make any in 1930?

Mr. TALLAFERRO. In 1930, as I remember, we made some, but not much.

Mr. McCORMACK. In 1929?

Mr. TALLAFERRO. Yes; we made money almost every year, except when the depression started, and previous to the depression, because a packer always loses money on a declining market. But we had a very great decline in production which necessitated a loss being shown by us.

Mr. McCORMACK. In other words, you had to equalize; your price level goes down sharply when the economic system is disturbed?

Mr. TALLAFERRO. The first thing that is affected usually, in an upset or decline in industry, or decline in business, is the packing business.

Mr. McCORMACK. In any event, there would be a sharp downward movement of the price level?

Mr. TALLAFERRO. Yes; and that is what made the difference in our earnings.

Mr. McCORMACK. Of course, when the decline came, you had to mark off the stock you had on hand and to take your losses.

Mr. TALLAFERRO. We sold the products we had, with the exception of what we used to pay the floor tax.

Mr. McCORMACK. Could you tell me what losses you sustained in 1930?

Mr. TALLAFERRO. No; I do not remember now.

Mr. McCORMACK. Will you send the committee, for the record, a statement showing the financial condition of your corporation at the end of 1929, and from that time to 1935, inclusive?

Mr. TALLAFERRO. We had working capital enough to carry the business along and were able to borrow when we needed it, to supplement that working capital.

Mr. McCORMACK. But that does not interfere with determining your statutory net income?

Mr. TALLAFERRO. No.

Mr. McCORMACK. Whether it is a profit or a loss.

Mr. TALLAFERRO. No; that does not have anything to do with the net income, but it has a very material bearing on whether we could borrow money.

Mr. McCORMACK. But the returns of your corporation would give an idea as to the trend. Did you lose more money in 1932 than in 1935?

Mr. TALLAFERRO. No; we lost more money in 1935 than we have lost in any year in the history of the business.

Mr. McCORMACK. Is your company a going company now?

Mr. TALLAFERRO. Our company, since we have not had to pay this tax, is a going business now.

Mr. McCORMACK. Are you in process of reorganization?

Mr. TALLAFERRO. No. We were, on account of the Government tax; but when the Government tax was declared invalid, we did not have a going corporation, therefore, we did not need any reorganization.

Mr. McCORMACK. Your company has not invoked the provisions of section 77-B, has it?

Mr. TALLAFERRO. We were, but not now.

Mr. McCORMACK. You mean you were contemplating it?

Mr. TALLAFERRO. No; we went under 77-B.

Mr. McCORMACK. You have reorganized it?

Mr. TALLAFERRO. Yes; with the intention to reorganize, which we would have attempted to do.

Mr. McCORMACK. Did you invoke the provisions of section 77-B? Has your corporation been in court under the provisions of section 77-B?

Mr. TALLAFERRO. Yes.

Mr. McCORMACK. When did you go in there?

Mr. TALLAFERRO. In January of 1935.

Mr. McCORMACK. Then you have been reorganized? Are you still subject to the jurisdiction of the court?

Mr. TALLAFERRO. No; not now.

Mr. McCORMACK. In other words, when the Supreme Court decision was handed down you did not continue the reorganization?

Mr. TALLAFERRO. No; a reorganization was not necessary then.

Mr. McCORMACK. In other words, your position is that you have absorbed the tax?

Mr. TALLAFERRO. We have absorbed the greater part of it; I will not say we have absorbed all of it, because I do not know, and no one can state. But I do know, from the results of the business, that the greater part, if not all, of that tax was absorbed by us.

Mr. McCORMACK. Personally, I voted against the processing tax, but do you agree that any of those companies who collected the tax should be permitted to retain it, where they passed it on? If any company paid the tax and passed it on, do you think it should be permitted to retain it?

Mr. TALLAFERRO. I am not a judge; I am only looking after my own affairs. I am not here in the interest of anybody else, or to make any statement.

Mr. McCORMACK. My question was not addressed to your particular company, but to the entire subject.

Assuming that some companies who have paid the tax have passed it on—

Mr. TALLAFERRO. Assuming that they have?

Mr. McCORMACK. Yes; and that they have retained the money in their possession; that they have it now. Do you think they should be permitted to retain it?

Assuming that the facts are all established, that they have paid the tax and passed it on, and now have it in their possession, do you think they should be permitted to retain it?

Mr. TALLAFERRO. May I ask you a question?

Mr. McCORMACK. Certainly; I do not know that I can answer it.

Mr. TALLAFERRO. Would you think that if the tax was illegal the Government is entitled to it?

Mr. McCORMACK. If we could trace it to the consumers, that would be different, but it would be very difficult to accomplish that. But if a corporation paid the tax, then you are asking me the question, and I will give you my answer. If the corporation paid that tax and passed it on to the consumers and collected it and now they have it, they ought to pay it.

Mr. TALLAFERRO. If the law under which they collected the tax was illegal?

Mr. McCORMACK. Let me ask you this question: If you have paid the tax, then you have in turn sold goods to someone else and you have collected that tax; if you have not paid the tax but you passed it on to someone else and you now have that tax in your possession, why should you be permitted to retain it? You are collecting at both ends and the middle.

Mr. TALLAFERRO. Who is entitled to it?

Mr. McCORMACK. Certainly you are not entitled to it if you have collected it, are you?

Mr. TALLAFERRO. Who is entitled to it? The Government is not.

Mr. McCORMACK. The Government is more entitled to it as against you, if it has been passed on to the consumer, when you cannot trace it to the consumer.

Mr. TALLAFERRO. If any part of the tax was passed to the consumer—

Mr. McCORMACK. The state of your mind might affect my position a lot. If you have not paid the tax and you have collected it and you now have it in your possession, do you claim you are entitled to retain that tax?

Mr. TALLAFERRO. Well—

Mr. McCORMACK. You can answer that yes or no.

Mr. TALLAFERRO. I would prefer not to answer it, but if you insist on an answer, I would say that the packer is entitled to the tax.

Mr. McCORMACK. Then I disagree with you.

Mr. COOPER. I understood you to state that in your case you did not pass the tax on.

Mr. TALLAFERRO. Yes.

Mr. COOPER. You understand the suggestion here would not affect you at all then, do you not, if that is true?

Mr. TALLAFERRO. You mean this law?

Mr. COOPER. Yes.

Mr. TALLAFERRO. How can you prove that I did, or how can I prove that I did not?

Mr. COOPER. That is all right, but if the fact is that you did not pass it on, you understand this suggestion would not affect you at all, do you not?

Mr. TALLAFERRO. How can you determine that?

Mr. COOPER. That is a matter that will have to be determined.

Mr. TALLAFERRO. You cannot unscramble that and pick out your egg.

Mr. COOPER. But if it can be determined, the tax would not be collected.

Mr. TALLAFERRO. Of course, that is something I am not here to decide.

Mr. COOPER. I just want to be sure you understand—

Mr. TALLAFERRO. I understand it perfectly.

Mr. COOPER. That if you did not pass the tax on, the suggestion here would not affect you at all.

Mr. TALLAFERRO. No.

Mr. FULLER. Mr. Witness, do you mean to say that the Government cannot tell whether or not you pass that tax on to the consumer?

Mr. TALLAFERRO. No; and no one in this God's world can tell that.

Mr. FULLER. You are a packer.

Mr. TALLAFERRO. Yes.

Mr. FULLER. Whom do you sell your product to?

Mr. TALLAFERRO. If I was one of our Congressmen I would be able to tell.

Mr. FULLER. You mean you would be able to do it?

Mr. TALLAFERRO. I would want to know who did it.

Mr. FULLER. You say you collected the processing tax? To whom do you sell?

Mr. TALLAFERRO. Whom do we sell to?

Mr. FULLER. Yes.

Mr. TALLAFERRO. We sell to dealers.

Mr. FULLER. All right. Do you not keep books, showing what you sell, and also showing the price for which you sell to consumers and dealers?

Mr. TALLAFERRO. To the consumer, no; but to the dealer I do.

Mr. FULLER. All right. You can tell whether or not you added on the 25 percent, or whatever it was.

Mr. TALLAFERRO. I did not do it.

Mr. FULLER. But suppose your books show that you did it. The books that you keep would show whether or not you did it, would they not?

Mr. TALLAFERRO. They could not tell whether I did or did not, only through inference.

Mr. FULLER. You mean that if I were to examine your books I could not tell?

Mr. TALLAFERRO. Absolutely, you could not tell because that tax was not a tax on me; it was a tax on our doing business.

Mr. FULLER. You could tell the price at which you sold the product.

Mr. TALLAFERRO. My books would.

Mr. FULLER. As to whether or not you had added the processing tax onto that price?

Mr. TALLAFERRO. If you can do that, you can do more than any other living man.

Mr. FULLER. Certainly, if you keep an honest set of books, there is no way in the world that you can keep from showing that.

Mr. TALLAFERRO. There is no way that it would be segregated or designated as showing whether there is any part of that tax passed on.

Mr. THOMPSON. How did your corporation handle its income-tax return for the years 1933 and 1934, pertaining to the processing tax expenses?

Mr. TALLAFERRO. The processing tax expense?

Mr. THOMPSON. The amount of money you paid the Government for the processing tax. How did you handle that in making your corporate income return for the years affected—that is, on your 1933 and 1934 business?

Mr. TALLAFERRO. We turned into the Government, according to their regulations, figures covering our earnings.

Mr. THOMPSON. Did you carry that item of processing tax expense as an expense of your business, and take a deductible credit, or not?

Mr. TALLAFERRO. No.

Mr. THOMPSON. If, as you say, you absorbed it, why did not you take it as a deductible credit?

Mr. TALLAFERRO. We did not ever pay it.

Mr. THOMPSON. You said you did pay it.

Mr. TALLAFERRO. No; we credited it to the Government, but we did not pay the tax and charge it in our expense.

Mr. THOMPSON. You paid \$386,000, according to your testimony, and you took that as an expense of the business on your return?

Mr. TALLAFERRO. I could not tell you about the details.

Mr. THOMPSON. Would not that be a controlling factor, as to whether you absorbed it or did not absorb it?

Mr. TALLAFERRO. My understanding is that the tax was not deducted in our income-tax statement, but I am not sure about that.

Mr. DINGELL. Mr. Taliaferro, what was the number of hogs that you people killed, on the average, in the course of a year?

Mr. TALLAFERRO. That has varied very much, Mr. Dingell, with the available receipts. Our minimum number that we can run every day, to make us competitive with the others, would be 4,000 hogs a week, 250 cattle a week, about 400 lambs, and about 300 calves. It takes that volume of business to put us on a competitive basis with the others.

Mr. DINGELL. What is the maximum number of hogs you kill, per year?

Mr. TALLAFERRO. We run about 350,000 or 360,000 in a year.

Mr. DINGELL. What was your low?

Mr. TALLAFERRO. Our low was in 1935, when we killed 125,000 hogs.

Mr. DINGELL. A little more than one-third?

Mr. TALLAFERRO. Just about a third.

Mr. DINGELL. Is it one of your problems in your business that as your hog production, or the packing of hogs is reduced, naturally your overhead is that much higher, per hog, and that in turn curtails your profit and increases the price of your fresh and smoked cuts?

Mr. TALLAFERRO. Absolutely.

Mr. DINGELL. And placing on the processing tax made it rather difficult for you to manufacture your pork products, in competition with beef, lamb, and other products?

Mr. TALLAFERRO. It made it not difficult, but impossible.

Mr. DINGELL. In other words, the discriminating public passed on pork cuts to buy other kinds of meat?

Mr. TALLAFERRO. Yes; they bought substitutes of every kind, and the papers made so much of the advance in meat, the high cost of pork especially, that the people would not buy it, and they are not buying it yet; they have not gotten over that aversion to the pork price yet.

Mr. THOMPSON. Because of the fact that the newspapers made so much of that, and built up such an agitation about the high price of pork, was not that agitated in some way by the pork packers blaming that on the action of the Federal Government by putting on the processing tax?

Mr. TALLAFERRO. I know of no specific case of that kind. I think the packers mostly felt that it was due to the drought more than to the A. A. A., because the A. A. A. never contemplated any such reduction in livestock as we had.

Mr. THOMPSON. You do not think that the salesman who travels out in the country around to the little meat markets and food stores did not say that the reason the pork was so high was because the Government was laying a processing tax of 2 1/4 cents a pound?

Mr. TALLAFERRO. They would have been perfectly justified in saying so, but I do not say that they did, or would do that.

Mr. THOMPSON. They would not be justified in saying it, my dear sir, if your contention is correct that the packers absorbed the tax.

Mr. TALLAFERRO. Some of them do, partly, and some of them do not, but we were in such shape that we were forced to absorb it.

Mr. DINGELL. You could not be held responsible for what your salesman happened to say in order to try to make his peace with an unruly butcher.

Mr. TALLAFERRO. No.

Mr. DINGELL. You stated that in 1934 and 1935 you paid approximately \$681,000.

Mr. TALLAFERRO. We did not pay it, Mr. Dingell.

Mr. DINGELL. That was the levy for those 2 years.

Mr. TALLAFERRO. Yes.

Mr. DINGELL. You still owe the Government \$879,653.09?

Mr. TALLAFERRO. We did owe them; we do not owe them now.

Mr. DINGELL. That has been paid off?

Mr. TALLAFERRO. No; that has been canceled by the decision of the Supreme Court.

Mr. DINGELL. I wanted to get those figures in the record.

Mr. McCormack. You do not feel, if you collected some of the taxes—

Mr. TALLAFERRO. If I had collected them?

Mr. McCormack. If the company had collected them, you do not feel that you should have to pay them but that you should retain them.

Mr. TALLAFERRO. If I could find out that such was the case, and if I owed an honest debt, I would pay it, as I always do.

Mr. McCormack. You are opening up a broader field than I have inquired into. I am not impugning your motives; I have asked a few simple questions, in a friendly spirit, but, frankly, your answer did not please me very much.

If you have not paid any part of the tax, and you have collected it from somebody else, do you still contend, as you have in response to previous questions—and I want to give you an opportunity to change your mind—do you still contend that, as against the Government, you should keep that tax?

Mr. TALLAFERRO. If I should give up the tax to anybody under those conditions it ought to be to the consumer.

Mr. McCormack. But you cannot do that.

Mr. TALLAFERRO. No.

Mr. McCormack. Do you think you should retain it as against the Government?

Mr. TALLAFERRO. Why should I not?

Mr. Treadway. In that connection, gentlemen have endeavored to make you say that, having collected some of the processing tax that is charged to the consumer, you should pay it to the Government. That is the effort that has been made.

Mr. TALLAFERRO. Yes, sir.

Mr. Treadway. You particularly avoided making any such statement?

Mr. TALLAFERRO. Yes, sir.

Mr. Treadway. Now, if through some process—

Mr. McCormack. He avoided what?

Mr. Treadway. He avoided saying what you wanted him to say.

Mr. McCormack. You can interpret it in your own way, but do not speak for me.

Mr. Treadway. I was coming to this point: You felt, after the decision of the Supreme Court, that you did not owe this money to the Government, did you not?

Mr. TALLAFERRO. I certainly did.

Mr. Treadway. But there was an effort made to have you say that, having collected it, you should pay it to somebody; that it did not belong to the Government according to the Court decision.

Mr. TALLAFERRO. Excuse me; will you ask that question again?

Mr. Treadway. Put it this way: If you had some money that you had collected according to law and then you found that the law was unconstitutional, having been so declared by the Supreme Court of the United States, should you be called upon to pay it to the Government, which had no right to it?

Mr. TALLAFERRO. Why, no; I should not pay the Government something that they are not entitled to.

Mr. Treadway. I think you have the right view of it. The Government had no right to that money, did it?

Mr. TALLAFERRO. Absolutely not.

Mr. Treadway. You are correct.

Mr. LAMNECK. I would like to ask you one or two questions.

After the Supreme Court of the United States declared the A. A. A. unconstitutional, how did you handle this unpaid tax? Did you take it into your earnings?

Mr. TALLAFERRO. Did I take it into my earnings?

Mr. LAMNECK. For 1935?

Mr. TALLAFERRO. For 1936.

Mr. LAMNECK. I wanted to find out how that made your 1935 operations show.

Mr. TALLAFERRO. The 1935 operations will show a liability of so much money to the Government, but they will not show when the tax was declared illegal; and this money that we owed the Government, or that we had under the orders of the Government, was returned to us, and will come in our statement of earnings in the year 1936.

Mr. LAMNECK. Let me ask you this question: How much money did you lose in 1935?

Mr. TALLAFERRO. I think it was about \$245,000. That is my memory of it. I do not want you to take that as being absolutely correct.

Mr. LAMNECK. That is an approximation?

Mr. TALLAFERRO. About \$245,000.

Mr. McCormack. I would like to have you send us a statement of the earnings of your company from 1929 to 1935, inclusive.

Mr. TALLAFERRO. Would you like me to go back 10 years?

Mr. McCormack. Yes.

Mr. TALLAFERRO. I will send that to you, covering 10 years, because since 1928 the conditions have been so abnormal that they would be no fair indication of any business proposal.

Mr. McCormack. Mr. Treadway told you we tried to make a lot of capital out of your avoiding to say what we intended to have you say. But let me say to you that when I ask questions I do not try to put in any witness' mouth anything that they do not say.

Let me see if you and I do not understand one another.

I understood your position was that in reference to this \$879,000 that you have not paid—let us take another company besides your

own, and call it, say, the McCormack Co., in the same business. Let us assume that that company did not pay \$879,000 in the processing tax, and that the Government owed it on January 6, when the Supreme Court spoke.

Let us say that I passed that on, that I sold products to the wholesaler, and that all those processed meats have gone into the hands of the consumers. The tax has been passed on. Your contention is that at the present time the Government should not undertake to collect that tax from me; is that right?

Mr. TALLAFERRO. No; you are asking me about an impossible proposition, because he does not know whether he has passed it along.

Mr. McCORMACK. I asked you to consider an assumed proposition, assuming that that is so, assuming that my corporation collected that amount of money from the wholesaler; do you contend that we should be permitted to retain that money?

Mr. TALLAFERRO. If I should not, who should be?

Mr. McCORMACK. You have not answered the question. Do you contend that I should be permitted to retain that money?

Mr. TALLAFERRO. I do.

Mr. TREADWAY. I understood you to say that this \$879,000, which you did not pay, and for which there is an illegal claim, as the result of the Supreme Court decision, has gone into your records and accounts of 1936?

Mr. TALLAFERRO. In 1936.

Mr. TREADWAY. So you still have your \$879,000 there for tax purposes—that is, legal taxes that may be laid against you—have you not?

Mr. TALLAFERRO. Whether it will be available for such purposes I cannot tell you, but the money is there.

Mr. TREADWAY. In other words, whatever is constitutionally the law on the 1st day of January 1937, requiring a report of your financial operations, for tax purposes, for the year 1936, the Government will have the opportunity, according to this report, to collect from you the part you legally and constitutionally owe the Government, out of that sum?

Mr. TALLAFERRO. According to the tax law, whatever the tax law is, if we report that as an earning it will be treated as an earning, or whatever is left, whatever part is left, will be treated as an earning, and we will be subject to the law as to earnings.

Mr. HILL. We thank you for your appearance and for the statement you have given the committee.

Mr. HILL (presiding). The next witness is Mr. Charles Warner, of Philadelphia.

STATEMENT OF CHARLES WARNER, PRESIDENT, WARNER BROS., PHILADELPHIA, PA.

Mr. HILL. How much time do you think you will need, Mr. Warner?

Mr. WARNER. It would take me about 7 or 8 minutes to present my statement. I do not know how much discussion may follow it.

Mr. HILL. We will recognize you for 8 minutes.

Mr. THOMPSON. What is your business, Mr. Warner?

Mr. WARNER. Building materials.

Mr. HILL. You may proceed, Mr. Warner.

Mr. WARNER. Mr. Chairman and gentlemen, I am neither a tax expert nor an economist. I am just an ordinary business man trying to find out where "he is at." I present a statement which applies particularly to my company's situation, but which I feel is typical of many enterprises that have been obsessed with this depression during the past few years in the heavy-construction industries.

This company and its predecessors had grown through several generations to the position on January 1, 1931, when its gross assets were about \$20,000,000. These assets comprised necessary raw material deposits of sand, gravel, and limestone; plants for preparing and manufacturing said raw materials, adjacent to Philadelphia; private railways and a fleet of barges and tugs required to transport some 5,000,000 tons per annum of prepared sands and gravels from our plants to our wharf distributing yards in Philadelphia and Wilmington; six active retail terminals with their repair shops, central-mixed concrete plants, storage bins, and warehouses; some 200 trucks required for retail distribution; and so forth. This business was then operating at about 80 percent of its capacity, and its annual volume of sales was in excess of \$12,000,000. For the past 4 years its sales volume has averaged under \$3,000,000 per annum, or less than 25 percent of normal.

In addition to its physical assets it required to handle this volume of business net working capital of approximately \$2,000,000. Even with this amount of net quick assets the company had to resort to seasonal borrowing, which had been its customary practice, more or less, for years when business extensively expanded in the spring, following the heavy winter overhauls required in this line of business. With actual net quick assets (working capital) on hand on January 1, 1931, of \$1,955,000, it was necessary in the spring of that year to resort to seasonal bank borrowing amounting to \$600,000, at the peak, which amount was subsequently paid off by liquidation of customers' receivables and reserve accumulations.

For the 5-year period from 1931 to 1935, inclusive, this company lost \$4,440,000, which includes dividends paid during the first 15 months of the period, of \$858,000. This loss is represented, in part, by an accumulation of back interest in the amount of \$1,003,320, to be paid out of future earnings according to a supplemental indenture negotiated with our bondholders for a moratorium period; in part, by a reduction of its net quick assets from the amount of \$1,955,000 on January 1, 1931, the minimum amount necessary to conduct this business in normal times, to \$1,166,000 on January 1, 1936, a loss of over \$800,000 in said working capital; in part, by the deferring of normal maintenance on plants and equipment estimated at over \$1,000,000.

In accordance with a plan of readjustment entered into with our security holders in 1933, and consistent with a prevailing depreciation of values at that time, the general assets of the company were revalued and the then earned deficit of \$2,845,000 was written off, leaving a present earned deficit as of January 1, 1936, of \$1,141,000. In the face of this earned deficit and with the obligation to pay back interest before payment of dividends, and with the necessary rehabilitation of plants and equipment, it would be the height of folly from

both a financial and a legal point of view for this company to pay any dividends out of future profits until it has accumulated substantially in excess of \$3,000,000 through future earnings. Any tax payments out of these future earnings that must be assigned to pay back debt and recoup other losses appear to me to be taxes on losses and not on profits.

Your subcommittee's report dated March 26, page 7, paragraph 20, proposes the only relief plan, so far as we can detect, for such a typical situation as ours, by recommending—

that a corporation which has prior to January 1, 1936, made a bona fide contract not to pay dividends or not to pay out as dividends a stipulated portion of its earnings and profits for the taxable year shall be taxed 22.5 percent on the part, etc.

This would mean that out of the first million dollars we earn, which would be payable to our bondholders for back interest, we would have to pay a tax amounting to \$225,000, which would further delay the distribution of such amount to the bondholders. In our estimation the payment of such interest should be deductible by the corporation from undistributed profits in the year paid, since such distribution becomes taxable to the recipient the same as dividends under the proposed law.

Your proposal would give such a typical case as ours, wherein back losses must again be restored to working capital and plant repairs and maintenance, so that the company may function normally, no relief from the very heavy tax schedules proposed for undistributed profits. To have such undistributed earnings, so vitally needed, taxed at the proposed rate of 42.5 percent will prove an unfair burden. We have a hard enough problem to try to save our company from bankruptcy, liquidation, and dismemberment.

Summing up our specific problem, your proposal would require us to pay \$225,000 on the million dollars required for back interest and \$850,000, at the rate of 42.5 percent, on \$2,000,000 which we must restore to working capital and expend on repairs and maintenance of plants and equipment. This is a total proposed tax in our case of \$1,075,000 out of the first \$3,000,000 of earnings needed to restore part of our back losses and to be applied for the purposes above cited.

Even the existing tax rate on corporation profits, if it continues and if the back interest on our debt is not deductible in the years paid, would amount to about \$450,000 on said \$3,000,000 at the present rate. Your proposal, therefore, burdens such a distressed corporate situation by an additional amount of over \$600,000 on the first \$3,000,000 of earnings.

The complete tax picture under your proposal is presented by determining the amount of taxes we would have to pay to accumulate the amount of \$3,000,000 net before we could resume dividends. The calculation shows that we would have to earn about \$4,770,000 and pay a tax of about \$1,770,000 in order to earn the net amount of \$3,000,000. Under existing law we would have to earn \$3,530,000 to secure a net of \$3,000,000. Hence, according to our calculations, our Federal tax under your new plan would be increased by about \$1,240,000 over that required by the present law.

This, gentlemen, is terrifically unfair in its application to any company in this extremely distressed condition, and which will have

a difficult struggle to get back on its feet in the next 4 or 5 years under the best of conditions.

I am not speaking only for myself and my fellow officers who have suffered severely by the continuation of this depression for the past 5 years, but I am speaking in behalf of 1,200 bondholders and 1,900 stockholders, who will all suffer in one way and another by such extreme tax penalties against a corporation which is struggling hard to carry on at this time and which under the best of conditions will have a long and trying period to recover its position physically and financially in the more prosperous years we are hoping for in the future.

Mr. HILL. Let me ask you this question, Mr. Warner: Are you on the accrual basis of accounting or on a cash basis?

Mr. WARNER. We normally are on an accrual basis of accounting; but, as respects the back-interest payments, which are only payable out of future earnings, that particular item is not accrued in our tax returns up to date.

Mr. HILL. That would be a deductible item from your income in arriving at your statutory net income in the year in which the interest is paid.

Mr. WARNER. So far as we know, that is a debatable question; that is, with the present practices of the Treasury Department, we believe we will be definitely assessed on future earnings without being able to deduct that, the back interest paid in some future years.

Mr. HILL. Then you are on the accrual basis; is that the idea?

Mr. WARNER. Normally, yes. On that particular item of back interest, we are not.

Mr. HILL. Then if you are not on the accrual basis as to that, you are on a cash basis as to that.

Mr. WARNER. I know, but the Treasury Department's customary practice is to treat such interest items on an accrual basis and only allow them to be entered on your books and deducted in the year primarily due.

Mr. HILL. That is all.

The CHAIRMAN. If there are no further questions, we thank you for your appearance, Mr. Warner.

Mr. WARNER. Mr. Chairman, there was just one question that I overlooked. You have a January 1 dating—January 1, 1936—on which the question of a back contract applies in allowing the 22.5 percent application in such cases.

I would like to say that I have a specific situation in one of our subsidiary companies where we undertook a refunding program through February. The contract was executed with the bankers for the refunding in that case on March 2, the day before the President's message to Congress on this tax subject.

Now, that contract with the bankers requires that the company build up a larger surplus before any dividends can be paid.

I call that point to your attention. It is merely in support of some other points of similar character that have been made here the last 2 or 3 days, because I feel that the January 1 dating in that particular connection is not exactly proper, and it should at least be March 3, or later, when, as I say, it first became a matter of knowledge to the people of this country.

The CHAIRMAN: I am sure that the committee will give proper consideration to that point.

Mr. REED: Mr. Warner, you talk about having gone into this refunding operation with the bank. Did they suspend their consideration pending this tax bill?

Mr. WARNER: No, sir; because the contract was entered into between our company and the bank, in that case, on March 2, and it required the building up of surplus.

Mr. REED: And the contract was closed?

Mr. WARNER: Yes, sir; the day before.

Mr. TREADWAY: Just one more question in that regard. Has your company had any communication from the bank people who loaned that money, as a result either of the President's message or this proposed bill?

Mr. WARNER: No. They merely expect us to live up to the terms of the contract of March 2 and build up the surpluses in that subsidiary company.

Mr. TREADWAY: And if you do that, you will be subject to a pretty severe penalty in the way of a tax, if this proposed bill goes into effect?

Mr. WARNER: We will, sir.

Mr. TREADWAY: In other words, you will get it coming and going; you will get it from the Government and the bank, too?

Mr. WARNER: That is right.

The CHAIRMAN: If there are no further questions, we thank you for your appearance and the testimony you have given the committee.

The next witness is Henry M. Powell, of New York.

STATEMENT OF HENRY M. POWELL, REPRESENTING ASSOCIATED INDUSTRIES OF NEW YORK STATE, INC., NEW YORK CITY

The CHAIRMAN: Will you state your name, your address, and the capacity in which you appear?

Mr. POWELL: My name is Henry M. Powell. My address is New York City. My office address is 51 Chambers Street, of that city.

The CHAIRMAN: How much time do you think you will need?

Mr. POWELL: Ten or twelve minutes, if the members of the committee will be patient with me until I have concluded my statement, when I shall be glad to answer any questions that I am able to answer.

The CHAIRMAN: We will try not to interrupt. You are recognized for 10 minutes.

Mr. POWELL: I represent the Associated Industries of the State of New York, Inc., and I am a member of its tax committee.

I have been counsel to the State tax revision commission of 1907—that is, the New York State Tax Revision Commission—and also to the 1914 State tax-revision commission, and I am a member of the committee on tax delinquency of the National Tax Association. I have contributed somewhat to the tax literature, on the subject of taxation of corporations, for State and local purposes, and of real-estate taxations for local purposes.

I want to tell you something first, about Associated Industries of the State of New York, which I represent here, as a member of its

tax committee, so that you may understand how we are affected by the taxes that you propose on undivided profits of corporations.

The association was incorporated in New York in 1914 to protect industrial organizations, manufacturers, and merchants from unreasonable and unnecessary legislation, and to cooperate with the legislature in well-considered labor laws and business generally, and we are today ready and willing to cooperate with your committee.

To give you an idea of the extent of our association, I will say that while it was incorporated originally with 39 manufacturers and corporations, it now represents 1,500 manufacturers and corporations organized or doing business in New York, and the members of the association now give employment to nearly 600,000 men and women out of an approximate aggregate of 1,300,000 wage earners of the State of New York, and the members of that association represent an invested capital of about 2 billion dollars.

Nearly all of the great manufacturing and mercantile corporations in the State of New York are members of that association.

The State of New York every year imposes taxes on about 150,000 corporations—and that is about one-third of the total number of corporations that file returns with the Treasury Department. So you can get some idea of the importance of our New York corporations compared with the great mass of corporations all over the United States. And these corporations are either doing business in our State or they are organized under our law. I do not mean to say that all these corporations have their property or employ their capital in New York. They file their reports or returns in that State and most of the larger corporations have their financial offices here.

Many of them have factories and offices in the State, or salesrooms, warehouses; but some of them have factories and salesrooms in many of the States of the Union; and they do business, some of them, in all of the 48 States. You can therefore see that this taxation of corporations is not a sectional or a local matter. It affects every State in the United States.

The New York Associated Industries does not object to any proposed form of taxation insofar as it provides for the necessary payment of governmental expenditures and the balancing of the Government's Budget; but it objects to the proposed plan of taxation as presented to your committee for the following reasons:

First, it is economically unsound in principle and it is a disturbing interference and an arbitrary regimentation of industry.

Secondly, it uses a yardstick or measurement with a progressive rate of tax irrespective of the character or the needs of the business. It makes no allowance for the shrinking of inventory values included as a part of profits and fluctuating greatly in various lines of business.

I can state from my own experience that I remember a concern in the paper business. It manufactured envelopes. But it was obliged by its business to keep a very large stock of paper. Now, that paper stock went up in value in 1919 and 1920, if my recollection serves me, but it has depreciated largely. That is part of the profits.

I have recollection of another concern in the millinery business that was capitalized at about \$1,600,000. Two-thirds of that was surplus. That surplus has entirely vanished now. This year it appears that

(they may have a good business and they may want to plow back a part of that surplus to make up their depleted capital.

You take the jewelry line of business, for instance, particularly the precious-stones line. From 1920 to 1930 there was a prosperous business there—or from 1920, perhaps, until 1929. After that and up to the present time, and probably for some years to come, most of these merchants and importers will have no business to speak of, because people are now interested in the necessities of life and not in luxuries.

Thirdly, this tax comes at a time when industry is beginning to recover from the effects of the depression and when there is some need of laying aside a store of undivided profits for future crises or depressions.

Fourthly, it fails to take cognizance between newly established business and those of long-established growth. The established business will not suffer so much as those that are new.

Fifthly, it disregards the needs of the States and local tax units, whose demands and requirements for revenue are proportionately as great and pressing as that of the Nation, and by taking away the current profits, leaves the corporation nothing with which to satisfy these demands except its capital.

I notice that Commissioner John J. Merrill, our corporation commissioner in New York State, and who has been retained by both Democratic and Republican administrations for the last 25 or 30 years, and who has been 40 years in that department, said in an address before the chamber of commerce yesterday, that the Federal Government and the State governments were taxing everything in sight that could possibly be taxed, and that left nothing for the local governments except real estate and real estate was overburdened.

So that now the State governments and the local governments will have to take capital for taxing purposes.

Sixth, the stockholder whose undivided profits are once taxed by this plan will pay a second time when he gets the dividends at a later date.

The proposed plan of taxation, I say, is economically unsound. After the war, when the Secretary of the Treasury recommended the repeal of the excess profits tax in 1920, there was a suggestion made at that time as a substitute for it of a tax on undistributed profits. That measure was debated at that time and found economically unsound.

I think Professor Adams, who was the Government advisor—he recommended the tax. He said that surtaxes were being evaded; people who have large stock interests do not have the dividends paid, if they are in control of the corporation. Prof. Charles Bullock, of Harvard, he opposed it. And at that time there was a discussion that came up in the National Tax Association, of which I am a member. All of the recommendations suggested by the President and the subcommittee in favor of the proposed plan of taxation were then urged. The fact that in some cases of incorporated business, large stockholders are able to retain their profits in the form of surplus is no economic justification for a progressive tax of all corporate industries.

This tax is primarily a tax on corporate business; and while no figures have been furnished by Mr. Helvering, of the Internal Revenue

Department, as to the proportion of unincorporated business, compared with corporate business, it is believed that the volume of corporate business to unincorporated business is at least 3 to 1.

It is a fact that corporate business has increased tremendously. The corporate form is now the form in which large business is done, and even small business. It is the most convenient form.

The argument that the unincorporated business pays on surtax and that the undivided profits of a corporation escape this surtax is not entirely sound, because eventually, when those earnings are distributed, they will bear the full normal and surtax, so that the stockholder will pay twice—once when the corporation pays it and again when he receives the earnings from the corporation at some future day, or if the corporation withholds its earnings and he sells the stock at an increased value.

I do not see anything in the subcommittee's report to make any allowance for the time when the surtax will be paid.

In a statistical study recently made it was ascertained that there were nearly 11,000,000 shareholders in this country. I think that is an understatement. It said of those 11,000,000, more than half participated in the ownership of enterprises, the largest in the Nation. The average stockholder owns less than 100 shares.

In 10 of the largest corporations of varied industrial character, stock holdings are approximately as follows: American Telephone & Telegraph, 675,927; General Motors, 350,742; Pennsylvania Railroad, 232,998; General Electric, 196,248; Electric Bond, 142,188; Standard Oil, 134,136; United States Gas, 123,423; Anaconda Copper, 119,620; Consolidated Gas, 119,255; Standard Brands, 110,100.

Those are 10 of the largest corporations. If you come to the next 10 or the next 20 or 30, you do not get quite as many stockholders, but they are a tremendous number. That shows you that the whole area of the United States is affected by a stock tax of this sort.

There is another feature of this proposed tax plan which, from the Government's point of view, you should consider, and that is, if you compel the corporation by this form of tax to divide all of its current profits, you are cutting off a large and steady market for Federal, State, and local government securities. Many of these large corporations hold as much as 50 percent of their surplus in these securities, and the amount of nontaxable securities now held in the surplus of these corporations probably runs into hundreds of millions of dollars.

I know of cases within my own observation where I was astounded by the amount of nontaxable securities that are retained in the surplus. Why do they retain it in the surplus? Not because they want to be tax-exempt, but because they want to have liquid assets for the propagation of the business of the company. That is the important point.

Now, while these large and comparatively few corporations with 100,000 shareholders or more may weather the storm of this new and untried system of taxing undivided profits, what will happen to the thousands of corporations with capital of \$100,000 to \$1,000,000, and with a small number of stockholders? Our best guess is to point out what has happened to them in the past 8 years. Many of them have gone out of business; perhaps it would be a fair estimate to say that at least one-quarter of them are no longer in business—one-quarter to

one-third. Of those that retained a reasonable surplus compared to their capital, the majority survived. But what has become of the surplus? A study of these smaller corporations will show that, with few exceptions, the entire surplus, or the larger part of it, was exhausted in paying the overhead charges of the company and keeping its labor and its employing staff. In many cases the capital itself has been impaired.

No concrete or complete tax bill has been presented by your committee, but the outline of the formulated plan leaves room for so much uncertainty as to its effect on business under its manifold phases that I am afraid that in its administration you will be obliged to supply more so-called "cushions" than were in the excess-profits tax, which was so difficult and impracticable in its administration that it was finally repealed. Only wartime conditions justified it at all.

Finally, industry and business should cooperate in the formulation of any tax plan intended to have any permanent duration. The reemployment of labor and the safeguarding of industry is as important as the raising of revenue.

A joint legislative committee, with representation on it of industry and labor, with ample time to formulate a comprehensive plan of taxation, is recommended.

Business is not yet ready in this Nation to be cataloged like guinea pigs. It is vital and constructive. It has aided the country in every crisis. Industry was a major force in the country's salvation in the Civil War and in the Great War. It is no less potent today.

The CHAIRMAN. If there are no questions, we thank you for the information you have given the committee.

The CHAIRMAN. The next witness is Mr. Frank H. Hall, of New York City.

(Mr. Hall did not appear.)

The CHAIRMAN. The next witness is Mr. David Stock, of New York City.

(Mr. Stock did not appear.)

The CHAIRMAN. I understand that it is expected that these two witnesses will appear this afternoon.

Mr. HILL (presiding). The next witness is Mr. Gay Gleason, of Boston, Mass.

STATEMENT OF GAY GLEASON, REPRESENTING THE EMPLOYERS LIABILITY ASSURANCE CORPORATION, LTD., BOSTON, MASS.

Mr. HILL. State your name and address and the capacity in which you appear.

Mr. GLEASON. My name is Gay Gleason, 33 Broad Street, Boston, Mass., representing the Employers Liability Assurance Corporation.

Mr. HILL. How much time do you want?

Mr. GLEASON. I think I can finish by 12 o'clock, if it please the chairman.

The CHAIRMAN. We cannot recognize you for more than 15 minutes. Mr. GLEASON. Very well, sir.

(Mr. Gleason submitted the following statement:)

The Employers Liability Assurance Corporation, Ltd., is a British corporation, organized in 1880. It was the first insurance company to write liability

insurance in the United States. In June of 1936 it will have been engaged in business in this country for 56 years. The corporation now does over 50 percent of its business in the United States and has over 6,000 foreign and domestic stockholders, many of whom have small holdings of 5 to 10 shares apiece. The principal office of the corporation in the United States is in Boston, but it maintains other large offices in buildings owned by it in New York and Philadelphia, as well as several branch offices and many agencies throughout the United States. It gives employment to thousands of United States citizens and pays large sums in city, county, State, and Federal taxes.

SUMMARY OF FEDERAL INCOME TAXES OF CORPORATION UNDER 1934 AND 1935 REVENUE ACTS

The corporation pays a 15-percent tax on all income from United States business. The corporation is also subjected to a withholding tax on dividends paid to nonresident alien shareholders of 4 percent paid to individuals and 15 percent paid to corporation shareholders. Since under British law the stockholders can sue the corporation for the full amount of their dividends without deduction in England, the corporation cannot deduct the tax from the dividends and must absorb this tax on dividends paid to nonresident alien stockholders.

FEDERAL INCOME TAXES ON THE CORPORATION UNDER PROPOSED REVENUE ACT OF 1936

The corporation must pay a 22½-percent tax on all net income from United States business, plus a withholding tax on all dividends paid to nonresident alien stockholders of 22½ percent, or a total tax of 45 percent. In addition thereto, the corporation must pay to the British revenue a tax of 22 percent on its income from all sources, it being a British corporation, making a total tax of 67 percent.

Domestic liability insurance companies, on the other hand, are subject to a tax of only 15 percent and foreign life insurance companies are subject to a tax of 15 percent, plus the British tax of 22 percent, or a total of 37 percent, even though such foreign life insurance companies are stock companies. (Report of subcommittee, p. 3, par. IV.)

ARGUMENT

I. TAXATION OF FOREIGN CORPORATIONS AND THEIR NONRESIDENT ALIEN STOCKHOLDERS UNDER THE REVENUE ACTS OF 1934 AND 1935

Under the 1934 Revenue Act, as amended by the Revenue Act of 1935, the corporation pays a graduated Federal income tax of 15 percent on the net income from its United States business. (Revenue Act of 1934, sec. 13, as amended by sec. 102 (a) of the Revenue Act of 1935.)

Thus, as to its income from United States business, the corporation is treated like a domestic corporation. With reference to its dividends under the 1934 act, the corporation is treated as a foreign corporation in that dividends are subjected to the normal tax, even though more than 50 percent of the gross profit of the corporation is derived from the United States. Formerly, the dividends of foreign corporations deriving more than 50 percent of their gross profits from United States business were exempted from normal tax. (Sec. 25 (a) (2), Revenue Act of 1932.)

Moreover, under the 1932 act, the dividends paid by such a corporation to a corporation holding stock of such a foreign corporation, whether such stockholder was a domestic or foreign corporation, were not subject to tax. (Sec. 23 (p), Revenue Act of 1932.)

Under the Revenue Act of 1934, section 25 (a) (2) of the Revenue Act of 1932 was eliminated, and accordingly the dividends of such a foreign corporation doing more than 50 percent of its business within the United States were subjected to the normal tax and the exemption of such dividends from tax when received by a corporation holding shares in such a foreign corporation was removed by a change in section 23 (p) of the Revenue Act of 1934.

Under section 119 (a) (2) (15) of the Revenue Act of 1934, the dividends of a foreign corporation deriving less than 50 percent of its gross income from United States business are not subject to tax when received by foreign stock-

holders, due to the fact that under said definition the dividends of such a foreign corporation are not deemed to be from sources within the United States. In the case of foreign corporations deriving more than 50 percent of their gross income from United States business, the United States now attempts to impose a tax on the full amount of their dividends received by nonresident aliens by means of a conclusive presumption under section 119 (a) (2) (B) (that the whole of such dividends are deemed to be from United States sources).

This produces the extraordinary situation which is hereafter more fully discussed, namely, that if a foreign corporation doing 49 percent of its business within the United States pays a dividend to a British shareholder, the British shareholder is subject to no tax thereon, but if the corporation does 51 percent of its business within the United States, the British shareholder is subject both to a normal and surtax on the full amount of this dividend, even though 49 percent of the dividend came from business done in England. (See appendix A.)

Prior to the passage of the 1934 Revenue Act, no withholding of a tax on dividends was required. Section 143 (b) of the Revenue Act of 1932 provided for a tax to be withheld on the payments of "fixed and determinable income" made to nonresident alien individuals. A similar withholding tax was provided on such payments to corporations by section 144. These withholding sections had never been applied to dividends due to the fact that dividends of foreign corporations doing less than 50 percent of their business within the United States were, by the terms of section 119 (a) (2) (B), deemed to be income from foreign sources, and the dividends of domestic corporations and of foreign corporations doing more than 50 percent of their business in the United States were specifically exempted from the withholding provisions by the express terms of section 143 (b), which exempted from withholding requirements the dividends referred to in section 25 (a) of the Revenue Act of 1932. As has been pointed out above, an exemption of such dividends from normal tax was provided by section 25 (a) (2) of the Revenue Act of 1932.

The Revenue Act of 1934 changed this situation. Although it is clear from a study of the Ways and Means Committee reports, with reference to the Revenue Act of 1934, that Congress had no intention of changing the withholding provisions of section 143 (b), the Treasury Department has taken the position that by taking away the exemptions under section 25 (a) (2) and 25 (b) of the Revenue Act of 1932, Congress (inadvertently) required withholding of a tax on dividends paid by foreign corporations deriving more than 50 percent of their gross income from United States business. (See appendix B; IT 2836, XIII-2 CH p. 81.)

The above income-tax ruling holds that dividends should be classified as fixed and determinable income within the meaning of section 143 (b) of the Revenue Act of 1934 and such dividends paid by a foreign corporation doing more than 50 percent of its business within the United States are subject to the withholding tax provisions of section 143 (b) and 144 of that act since such dividends are to be treated as entirely from United States sources under section 119 (a) (2) (B) of the Revenue Act of 1934, and they are no longer exempt under section 25 (a).

II. THE REVENUE ACTS OF 1934, AS AMENDED, AND THE PROPOSED 1936 ACT UNJUSTLY AND UNWISELY ATTEMPT TO TAX ALIEN NONRESIDENT STOCKHOLDERS OF FOREIGN CORPORATIONS.

A. THE PROPOSED WITHHOLDING TAX ON DIVIDENDS IS UNFAIR TO SMALL STOCKHOLDERS.

Under the provisions of the Revenue Acts of 1934 and 1935, nonresident aliens deriving less than \$1,000 of income from sources within the United States are exempt from normal tax. The average number of individual nonresident alien stockholders of Employers' Liability Assurance Co. is slightly more than 9,000, of which only 113 receive more than \$1,000 in dividends from Employers' Liability Corporation.

The corporation, of course, is unable to get any definite information as to whether these small stockholders have any further income from sources within the United States. It should be noted, however, that the corporation is a British corporation and that in investing in a British corporation, a British resident would not think for a moment that he was subjecting himself to a United States income tax, any more than a United States resident would think

that he was subjecting himself to a foreign income tax by investing in an American corporation which happened to be doing part of its business abroad. It is more reasonable to suppose that a foreign stockholder in an American company would be likely to have other income from United States sources due to the fact that he has shown a disposition to invest in the stock of American corporations rather than corporations in his home country.

The small stockholders of Employers' Liability Assurance Co. who derive less than \$1,000 of income from United States sources would be exempt from tax under our present law. The proposed 1936 act, however, requires that a tax of 22½ percent be withheld on all dividends paid by a foreign corporation to nonresident aliens and the Commissioner of Internal Revenue is authorized to grant refunds of such taxes if overpaid (par. XXIII).

With reference to other types of income from United States sources, other than dividends, the Commissioner has customarily allowed the filing of so-called exemption certificates with the withholding agent, which exemption certificates are checked before the corporation must pay the tax, and the Commissioner directs the withholding agent to pay the withholding tax only on payments made to individuals who have income from United States sources in excess of the exemption.

When IT 2836 was published with reference to the withholding-tax provisions under the 1934 act, the Commissioner refused to grant the use of exemption certificates with reference to the tax on dividends and ruled that the only way that such small stockholders could secure their exemption was by filing an income-tax return and claim for refund. It is presumed that the Commissioner will take a similar position under the 22½-percent withholding tax under the proposed 1936 bill. This will mean that these small stockholders, who are admittedly subject to no United States tax, may have 22½ percent of their dividends withheld, and their only redress is to go to the long, expensive process of filing income-tax returns showing no tax due and a claim for refund.

To ask a foreigner in the small-income class, who has no knowledge of our income-tax laws, to make up a complicated American tax return and claim for refund and go through the proper procedure to secure such a refund is certainly unreasonable. In fact, it looks like a clear attempt to arbitrarily collect a 22½-percent tax from such small stockholders without any expectation that they will ever get back the money.

B. THE PROPOSED WITHHOLDING TAX ON DIVIDENDS PAID BY FOREIGN CORPORATIONS IS CONTRARY TO THE PRACTICE OF GREAT BRITAIN AND INVOLVES GRAVE INTERNATIONAL DIFFICULTIES.

By assessing a 22½-percent tax on all net income from United States business and then attempting to collect a withholding tax on all dividends paid by a foreign corporation to nonresident alien stockholders the United States Government is really imposing double taxation, which is unjust and discriminatory and will result in international complications.

Due to such confiscatory double taxation, foreigners will not wish to invest in American business, and the withdrawal of the large foreign financial support of our businesses will have an adverse effect on domestic as well as foreign corporations doing business in the United States, and may well have a very depressing effect upon our security and commodity markets. Admittedly, foreign investments in the United States are tremendous and the precipitant withdrawal of these funds cannot help but set back the recovery of American business. Moreover, foreign countries, such as Great Britain, which do not now discriminate against American business and American investors, will attempt retaliatory measures which may have a serious effect on our foreign trade.

The British revenue at present does not attempt any such similar collection of taxes on dividends paid by American corporations doing business in England. Nor does it in fact attempt to collect taxes on American shareholders in British corporations doing business in England.

The present rate of British income tax on corporations is approximately 22 percent. There is, however, no withholding tax on dividends paid to stockholders in the sense of the withholding tax on dividends under the proposed Revenue Act of 1936.

The British law provides that after having paid the corporation tax (of approximately 22 percent) to the British revenue, the corporation may withhold a tax at the current rate (i. e., 22 percent) on dividends paid to stockholders in the current year. Practically speaking, this really amounts to a passing on

of a portion of the corporate tax. There is no compulsion on the corporation to state in its dividend declaration that a tax was paid at source. The provision simply gives the corporation the opportunity to indicate to its shareholders the tax on the corporation income as distributed.

The corporation, having paid the 22-percent tax, does not withhold a further 22-percent tax from the dividends and pays the amount so withheld to the British Crown, making in all a 44-percent tax, which would be equivalent to the proposed provisions under the Revenue Act of 1936. There is just one tax of 22 percent paid. The British authorities are absolutely clear on this point: When the company pays its 22-percent tax to the British revenue, it is in no sense paying a tax on behalf of the shareholders, as a withholding agent to collect a tax from the shareholder. (Konstant, *The Law of Income Tax*, pp. 269, 270.)

The permissive provision under which the British corporation purports to deduct a tax in paying the dividends is merely to indicate the amount of the dividend income on which the British shareholder would be liable for the so-called surtax (formerly called emmentax) of Great Britain. If a statement with regard to such dividend deduction is not made in declaring and paying the dividend, the shareholder would be deemed to have received a larger dividend from the corporation. In this way, the statement with regard to dividend deduction operates as a relief to the shareholder and not as a real deduction of tax which would be paid by the corporation to the British revenue.

That British income taxes, paid by a corporation to the British revenue, are in fact taxes paid by the corporation and not taxes on the shareholder has been decided by our own Federal courts in connection with a determination of whether such taxes constitute a foreign tax credit of the corporation doing business in the United States or a foreign tax credit of the shareholder (*St. Helens Petroleum Co., Ltd., v. Welch*, C. C. A. 9 (July 9, 1935), 78 F. d. (2) 631).

In that case, the *St. Helens Petroleum Co.*, in computing its net income subject to United States income and excess-profits taxes, claimed a credit to deduct income taxes paid to Great Britain. The Bureau of Internal Revenue took the position that such taxes were in fact taxes on the shareholders and therefore not a proper deduction to be taken by the corporation. The circuit court of appeals, however, held that the taxes were in fact taxes of the corporation and not taxes of the shareholders, and that the corporation was entitled to the deduction. The Department of Justice has accepted this decision and did not present the case to the United States Supreme Court. (See appendix C.)

The Bureau of Internal Revenue in the case of *Mary Duke Biddle v. Commissioner* (U. S. R. T. A. (Sept. 30, 1935) 23 B. T. A. —), took a position opposite to that which it had taken in the *St. Helens Petroleum Co. case* and claimed that the tax was in fact a tax on the corporation and not a tax on the shareholders and, therefore, that Mrs. Biddle and the other petitioners who were shareholders in a foreign corporation were not entitled to take in their returns a credit for the so-called tax deducted at source by the British corporation. The Board of Tax Appeals held that the tax was in fact a tax on the corporation and not a tax on the individual shareholder, and accordingly the shareholders were not entitled to take a credit for such taxes allegedly deducted in paying the dividends. The *Biddle case* relied on the decision of the United States circuit court in the case of *St. Helens Petroleum Co., Ltd., v. Welch*, *supra*.

It is clear from the above decisions that even our own courts and the United States Board of Tax Appeals concede that the British income tax paid by the corporation to the British revenue is not a withholding tax on dividends paid to stockholders.

Moreover, there is certainly in the British income-tax law no such arbitrary provision as is to be found under the United States Revenue Act, section 110 (a) (2) (B), arbitrarily providing that if an American corporation does more than 50 percent of its business in England then all of the dividends paid by such a corporation are deemed to be from its English business, so as to subject the American stockholders of such an American corporation to a British income tax on the dividends received from such American corporation. Such a provision would be illegal, arbitrary, and contrary to the facts and the law. An extensive investigation of the British income-tax law by counsel has failed to disclose any such provision. Such an American corporation doing business in England pays only the corporation tax of approximately 22 percent on the net income from its British business and then pays its dividends from its

United States office to its United States stockholders without any deduction of tax on the dividends. Certainly if England should attempt any such deduction, our State Department would lose no time in complaining at once to the British Foreign Office.

In fact, our State Department has already negotiated with other foreign countries in an effort to secure treaties avoiding double taxation of the respective nationals of the countries involved. (See Franco-American Double Taxation Treaty; Convention and Protocol Between United States of America and France, signed at Paris Apr. 27, 1932; ratified by the Senate of the United States June 15, 1932; proclaimed by the President of the United States Apr. 10, 1935. U. S. Government Printing Office, Treaty Series No. 885.)

III. THE PROPOSED BILL DISCRIMINATES UNFAIRLY AGAINST FOREIGN STOCK LIABILITY AND FIRE INSURANCE COMPANIES

Recommendation IV of the subcommittee report provides that bond-life insurance companies (mutual and stock, foreign and domestic) be exempted from the graduated plan proposed under recommendation II and be subject to a tax of 15 percent in lieu of the graduated rates under existing law, except that foreign insurance companies other than life and other than mutual be subject to a rate of 22½ percent in lieu of the graduated rates.

It is presumed that insurance companies in general were exempted from the proposed graduated rates on undistributed adjusted net income, due to the fact that insurance companies by law and by the very nature of their business must accumulate surpluses and reserves for the protection of their policyholders. It is submitted that the reasons given for the exemption apply to foreign corporations as well as to domestic corporations. No explanation is given, and in fact there can be no valid reason, for discriminating against liability and fire insurance companies in favor of foreign life insurance companies. Both are subjected to the same severe provisions of State laws with reference to setting aside reserves and surpluses. Nor has any reason been advanced for discriminating between domestic fire and liability insurance companies and foreign fire and liability insurance companies.

If domestic fire and liability insurance companies and foreign stock life insurance companies are to be placed in the 15-percent class, then foreign stock liability and fire insurance companies should also be put in the 15-percent class. Apparently the sole purpose of the President's message and of the proposed change in the corporate income tax with reference to accumulated earnings is to force the declaration of dividends and thereby increase the amount of surtax collected from the stockholders. Insurance companies, being unable to declare out the full amount of their earnings, due to requirements of State laws and the nature of their business, should not be subject to the proposed tax on accumulated earnings. It cannot be said that the 22½-percent rate on foreign liability and fire insurance companies will induce the paying out of dividends, due to the fact that this rate is not a rate on accumulated earnings, but is a flat rate on the entire net income of the corporation without reference to whether or not dividends are declared.

It is submitted, therefore, that foreign stock liability and fire insurance companies should be placed in the 15-percent class under recommendation IV and subjected to the 15-percent rate of tax on all net income from United States sources.

IV. THE PROPOSED 22½-PERCENT WITHHOLDING TAX ON DIVIDENDS PAID BY FOREIGN CORPORATIONS TO NONRESIDENT AGENT STOCKHOLDERS AND TRUSTS AND MAY BE INEFFECTIVE

A. SUCH TAXES ARE ILLEGAL

The recent Supreme Court decision of *Burnet v. Brooks* (288 U. S. 378) points out that, although the Constitution does not place limitation on the power and jurisdiction of Congress to tax nonresident aliens, the rules of international law do impose such limitations. These rules in the absence of treaty are determined by the customs and usage of civilized nations. (See appendix D; *The Paquete Habana*, 175 U. S. 677, at p. 709; see appendix E.)

The Supreme Court has repeatedly affirmed the proposition that taxes constitute compensation to Government for protection afforded by its laws. Thus

the power and jurisdiction to tax has been upheld where the protection of Government has extended to the person of the taxpayer (due to his presence here or citizenship); to the property of the taxpayer; or to the performance of contracts, or carrying on of activities within the United States.

The nonresident alien stockholders of a foreign corporation doing business within the United States, receiving dividends at the home office of the corporation abroad, declared on shares of stock, the certificates representing which are held abroad, are entirely outside the jurisdiction and power of Congress to tax under all recognized principles of international law. Such limitation is recognized by the British revenue authorities and they make no attempt to impose taxes under similar circumstances.

The foreign corporation itself may be taxed because it does receive the protection of the United States to the extent that it conducts business in this country, but unless the identity of the corporation and that of its stockholders are improperly merged into one, the stockholder does not receive the benefit of such laws. The source of his dividend is the home office of the foreign corporation abroad, and it is illegal for Congress to impose any tax on the theory that such source is within the United States.

When the United States branch office sends funds to the home office of the corporation in London, those funds are mingled with the other funds of the corporation and lose their identity as income from United States sources. Thus, when the corporation in London, later declares and pays a dividend, it certainly cannot be said that this payment is received by its shareholders from United States sources.

There is no basic distinction between this situation and the situation which would result if Massachusetts should attempt to tax the New York stockholders of a New York corporation on all dividends paid by the New York corporation to New York, on the ground that the New York corporation was authorized to conduct business in Massachusetts, and did conduct a substantial portion of its business in that State. Were every State of the Union to pass similar laws, it is readily apparent what would happen to the corporation and its stockholders; and similarly were every nation of the world to impose taxes like the ones here in question on the stockholders of every corporation that did business in any such nation, without regard to the settled principles of international law imposing restrictions on the jurisdiction and power to tax, foreign commerce would be obliterated.

§ 22. THE PROPOSED 22½ PERCENT WITHHOLDING PROVISIONS WILL BE INEFFECTIVE TO COMPEL PAYMENT OF SURTAXES BY NONRESIDENT ALIENS.

Section 22 (d) of the Revenue Act of 1934 provides that dividends are taxable to shareholders. The whole set-up of the revenue act is based on the fact that the corporate entity is recognized, i. e., corporations pay a tax on their own income and the individual shareholders pay a tax on theirs, whether received by way of dividends or otherwise. Attempts to tax nonresident alien individual stockholders of foreign corporations are not additional taxes on the foreign corporations whose stock they hold, but are taxes upon the stockholder himself.

Because he cannot be reached without difficulty, the foreign corporation is made an agent of the Government under the provisions of section 143 (b) to withhold, make return of, and pay the tax, which is essentially a tax on the shareholder. A dividend being a debt upon its declaration and immediately payable, a British stockholder could sue in London for the amount of his dividends so withheld by the foreign corporation and would prevail because a British court would not uphold the validity of a tax imposed on British citizens in utter disregard of all the principles of international law. After the corporation had paid such a judgment, it would have suffered a loss and would be entitled to indemnity under the provisions of section 143 (c), i. e., "Every such person is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this section." Indemnity as used in this section does mean refund or its equivalent since the United States would be powerless to sue the British stockholder in England.

The proposed 1936 act, page 8, recommendation XXIII, is set up on the theory that the British stockholder who felt aggrieved by the excessive withholding of 22½ percent would seek adjustment by filing a return and making a claim for a refund of any overpayment. This he certainly would not do if he could much

more easily and quickly accomplish a better result by suing the corporation in his own country. Thus it will be seen that merely imposing a very high withholding tax will not compel the foreign stockholder to file a return in the United States and will entirely fail of collecting any tax so long as the indemnity provision remains in section 143 (c).

If the tax remains in its present form, namely, a tax on the shareholder, it would seem clearly unconstitutional to require the foreign corporation to pay the tax from its own property without the indemnity provision. This would be taking the property of A for B's tax without giving A any chance to recoup. It has been repeatedly held that such a taking is illegal.

As a practical matter, the British corporation cannot, even though required by the United States revenue act, do something (namely, withhold a United States tax from its shareholders) when this is forbidden by British law. Therefore, the British corporation must pay the withholding tax on dividends paid to its nonresident alien shareholders and absorb the tax itself. In this way the United States Government attempts to collect a tax to which it is not entitled.

CONCLUSIONS AND RECOMMENDATIONS

Since the proposed revenue bill of 1936 contemplates practically a complete revision of the system of taxation of corporation income and its distribution, it is submitted that the unjust and illegal taxation of nonresident alien stockholders of foreign corporations doing business in the United States be thoroughly reviewed and corrected at this time.

As has been pointed out above, the imposition of a flat rate of tax on foreign corporations is a variation from the proposed general scheme of taxation of undistributed earnings. There can be under such flat rate of tax no purpose to cause a greater distribution of dividends, and thus higher surtax on the shareholders of such foreign corporations. Basically, from the point of view of jurisdiction, the United States has no jurisdiction to tax the nonresident alien stockholders of foreign corporations. But the United States has jurisdiction and can and does tax such foreign corporations on their net income from their United States business.

By such a flat-rate tax on foreign corporations the Government is paid for the protection it affords to such foreign corporations. A corporation having a net income of \$100,000 from United States business pays \$15,000 to the Federal Government. A corporation having a net income of \$200,000 from United States business pays \$30,000 to the Federal Government. This is a proper charge for the protection afforded by the United States and is based on the net income of the business protected. As the net income increases the tax collected is proportionately higher.

A ratio of the business transacted here to the business done abroad would have no relation to the tax to be paid here. Thus, if two corporations each have a gross income in the United States of \$100,000, but one corporation does twice as much business as in a foreign country as does the other, there would be no reason for a different rate of tax upon the business done here.

Under the proposed scheme, domestic corporations are to have the advantage of being able to declare out all of their earnings in dividends and thus avoid all corporate income taxes. A domestic corporation could do \$100,000 worth of business and pay \$100,000 in dividends and pay no tax. It is obvious, therefore, that with reference to domestic corporations, the subcommittee hopes to secure the Government's income from surtaxes on the shareholders. Foreign corporations are to have no such opportunity to reduce their corporation income taxes under the proposed revenue bill of 1936. They are to pay a flat rate of tax on all their net income from United States business, even though they may distribute all of such net income in dividends. By establishing such a flat rate on foreign corporations, it is obvious that the subcommittee is attempting to collect the fair amount of tax from the foreign corporation itself, and accordingly should not attempt thereafter to collect an additional tax on the income of the corporation paid to the stockholders and dividends.

If a domestic corporation under the proposed Revenue Act of 1936 pays out in dividends all of its net income and therefore avoids all corporate income taxes, its shareholders must on the average receive at least \$58,000 a year apiece in order to have the Government collect 15 percent on the income so distributed by way of normal and surtaxes. Under the Revenue Act of 1934, as amended by the Revenue Act of 1935, an individual taxpayer must receive a total net income of approximately \$38,000 in order to have a combined net

and surtax of 15 percent on his total net income. Thus, if the foreign corporation pays 15 percent on its entire net income received from the United States, the United States is in the same position it would be in the case of a domestic corporation paying out all its income in dividends to shareholders whose average income is \$38,000 apiece per year.

It is obvious, therefore, that to achieve the purpose of collecting a fair revenue on the United States business of a foreign corporation the flat rate of 15 percent is fair, and that the addition of a 22½-percent withholding tax over and above such flat rate is grossly unjust and discriminatory.

In order to justify the 22½-percent withholding tax on nonresident alien shareholders, it is necessary to presuppose that the average stockholder of such foreign corporation receives income from United States sources at least \$25,000 annually. Under the 1934 Revenue Act, as amended by the 1935 act, an individual taxpayer must receive approximately \$25,000 in order to pay a combined normal and surtax of 22½ percent on his total net income. Moreover, as has been submitted above, the United States has no jurisdiction to tax such nonresident alien stockholders of foreign corporations or to require the corporation to withhold a tax on dividends paid to such nonresident alien stockholders.

Accordingly it is submitted and recommended:

(1) That foreign-stock liability and fire-insurance companies doing business in the United States should be included in the insurance classification under recommendation IV and taxed at the basic rate of 15 percent on all net income from their United States business rather than under the 22½-percent rate in the proposed revenue bill.

(2) That the proposed withholding tax of 22½ percent on dividends paid by foreign corporations to nonresident alien stockholders be eliminated.

(3) That the tax on nonresident aliens on income actually received from sources within the United States be continued.

(4) That it be recognized in the provisions of the bill that dividends from a foreign corporation doing business in the United States and paid abroad to nonresident aliens are not income from United States sources and accordingly that section 119 (a) (2) (B) be eliminated from the Revenue Act.

(5) That section 143 (b) of the Revenue Act of 1934 be amended to exclude from the withholding provisions dividends paid to nonresident alien stockholders by foreign corporations doing business in the United States.

Respectfully submitted,

ALLAN H. W. HIGGINS,
RICHARD M. NICHOLS,
GOODWIN, PROCTOR & HARRIS.

Attorneys for Employers' Liability Assurance Corporation, Ltd.

APPENDIX A

Section 119 (a) 2 (B) of the Revenue Act of 1934 arbitrarily classifies as income from sources within the United States the entire amount of a dividend received from a foreign corporation by a nonresident alien shareholder when such foreign corporation derives 50 percent or more of its gross income from its United States business.

Thus, if a foreign corporation derives 50 percent of its gross income from its United States business and has a total net income of \$100,000 from all sources, available for dividends, and distributes all of such net income in dividends to its nonresident alien shareholders, the \$100,000 received by such shareholders is all deemed to be from United States sources, when as a matter of fact only \$50,000 of such net income may be from United States sources.

If a foreign corporation derives 40 percent of its gross income from its United States business and has a total net income of \$100,000 from all sources available for dividends, and it distributes all of such net income in dividends to its nonresident alien shareholders, then under the terms of section 119 (a) 2 (B) the \$100,000 of dividends received by nonresident alien stockholders is all deemed to be from foreign sources, and such shareholders would pay no United States income tax thereon.

To place this arbitrary classification upon the basis of the proportion that the gross income from United States sources bears to the income from all sources is arbitrary and unsound. This is illustrated by the case of a foreign corporation which derives 50 percent of its gross income from United States sources but the

net operations from United States business result in a loss. If the total net income of the corporation is \$100,000 and the United States operations were carried on at a loss, nevertheless under section 119 (a) 2 (B) the \$100,000 paid out in dividends to nonresident alien stockholders is all deemed to be from United States sources. This is clearly unsound.

A further illustration of unsound and arbitrary classification is to be found in section 119 (a) 2 (A), which provides that if a domestic corporation derives less than 20 percent of its gross income from its United States business, then the whole of the dividend paid by such United States corporation to nonresident alien stockholders is deemed to be entirely from foreign sources, even though 19 percent of such dividend may actually be derived from United States business. There would seem to be no reason why the dividing line for domestic corporations should be based on 20 percent of gross income and the dividing line for foreign corporations should be 50 percent of gross income.

It is submitted that the entire classifications of income from sources within the United States provided in section 119 is not only unsound but illogical.

It is further submitted that any classification of dividends as being from sources within or without the United States which is contrary to the facts is illegal.

APPENDIX B

The subcommittee of the Committee on Ways and Means, in its report recommending the omission of section 25 (a) 2 of the Revenue Act of 1932 in the enactment of the Revenue Act of 1934, stated, at page 14 of said report, as follows:

"(6) Dividends from foreign corporation: Section 24 (p) (2) and section 25 (a) (2) treat dividends from a foreign corporation in the same manner as dividends from a domestic corporation, provided such foreign corporation receives more than 50 percent of its gross income from sources within the United States. Your subcommittee is of the opinion that all dividends received from foreign corporations should be treated alike, regardless of whether such foreign corporation has income from sources within the United States. Accordingly, it is recommended that section 24 (p) (2) and section 25 (a) (2) be eliminated. The effect of this recommendation will be (a) to deny a deduction to a domestic corporation for all dividends received from foreign corporations and (b) to deny to any individual receiving such dividends the exemption from normal tax."

Thus the subcommittee stated that, in its opinion, all dividends received from foreign corporations should be treated alike, regardless of whether such foreign corporations had incomes from sources within the United States.

If this was the intention of Congress in enacting section 25 of the Revenue Act of 1934, then at that time section 119 (a) (2) (B) should have been eliminated.

Moreover, if the intention of the Ways and Means Committee at the present time is the same as it was at the time of the enactment of the Revenue Act of 1934, with respect to the treatment of foreign corporations and the stockholders of such foreign corporations, then there should be no distinction made between foreign stock life insurance companies, foreign stock liability insurance companies, and foreign stock fire insurance companies.

Furthermore, with respect to the provisions for a withholding tax on dividends under the proposed 1936 bill, the dividends of all such foreign corporations should be treated alike. It should be noted, however, that it is contended, as is stated elsewhere in this brief, that the United States has no jurisdiction to tax the nonresident alien shareholders of foreign corporations on the dividends received by them, and that accordingly there should be no withholding tax on dividends of such corporations.

APPENDIX C

WELCH v. ST. HELENS PAPER CO., 78 F.2d 621 (Circuit Court of Appeals, Ninth Circuit, July 9, 1935)

In this case a British corporation doing a large part of its business in the United States, sought in computing its net income for the purpose of its Federal income tax to take as a deduction the tax paid to the British Government by

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the corporation upon income derived by it from sources within the United States.

The United States Commissioner of Internal Revenue contended that the tax paid by the British corporation was, in fact, deducted from the dividends paid by the corporation in the current year, and accordingly was a tax on the shareholder and not a tax on the corporation. The Commissioner therefore contended that the stockholder and not the corporation would be entitled to take a credit for said tax.

The United States Circuit Court of Appeals for the Ninth Circuit, held that the tax paid by the corporation to the British revenue, was in fact a tax on the corporation and not a tax on the shareholder and that the corporation was accordingly entitled to deduct the tax in computing its net income subject to United States income tax.

The court said (p. 633) "that the tax in question was a tax paid to the British Government by the corporation is conceded. * * *. It appears from the British statutes and decisions quoted by the parties and presented to this court by stipulation that under the law of Great Britain, although the tax upon the profits of the corporation is paid in the first instance by the corporation at the current rate for the year in which the tax is paid, when the corporation thereafter declares a dividend from its profit, it may deduct from the dividend paid to each stockholder a credit for the payment of such tax equal to the tax upon the amount of the dividend at the current rate for the year in which the dividend is paid. It thus appears that, if the tax rate in the year in which the tax is paid by the corporation differs from the tax rate in the year in which the corresponding dividend is paid to the stockholder, the amount paid by the corporation and the amount retained by the corporation from the dividends paid would not be identical." The court then goes on to point out that the amount deducted as a so-called tax in paying the dividend is not in fact paid over to the British revenue by the corporation.

The court quoted at length from the British case of *Newmann v. Commissioners of Internal Revenue* (K. B.) 40 T. L. R. 1 (C. A. 1883) 1 K. B. 728 and (H. L. 1884) (A. C. 215) in which the court said:

"The company is not bound but only authorized to deduct tax in paying dividends; whether it deducts or not is left to its discretion because the profits once having been taxed in the company's hands, do not bear further tax (apart from surtax) in the shareholders' hands. There is in fact only one profit, no new profit being created from the fact that the shareholder gets his share: the tax is a tax on the profits and not on the dividend."

APPENDIX D

BURNETT v. BROOKS, 288 U. S. 378 (U. S. SUPREME COURT, MAR. 13, 1933)

This case involved a question of whether or not the United States could subject to the Federal estate tax, the property of a British decedent (a non-resident alien) who, at the time of his death, was not a resident of the United States and was not engaged in business in the United States, although, at the time of his death, he owned property consisting of securities including bonds of foreign corporation, bonds of domestic corporations and stock in foreign corporations, which securities were in the offices of decedent's agent in New York, who collected the income on such securities and placed it to the credit of the decedent in New York banks. The United States Supreme Court held that the intangible property of this nonresident alien decedent was subject to the Federal income tax to the extent that such securities were physically present in the United States and thus subject to the protection of the United States laws. The decision of the Court was that the sole basis for jurisdiction to tax this intangible property of a nonresident alien decedent, was the fact that these securities were physically present in the United States and thus were receiving protection from the United States laws.

The Court recognized that the power or jurisdiction of the United States to tax must rest upon one of three factors: (1) Citizenship or residence within the United States; (2) ownership of property in the United States; (3) carrying on of activities within and under the protection of the United States.

The Court further stated at page 400, "We determine national power in relation to other countries and other subjects by applying the principles of jurisdiction recognized in international relations."

The principles involved in the jurisdiction of the United States to tax non-resident aliens are limited to the three bases of jurisdiction set forth above. The Supreme Court in its opinion (p. 396) referred to the case of *Winans v. Attorney General* (1910 A. C. 27) which is a British case involving the British estate tax where the British House of Lords enunciated the same principles.

It is clear, therefore, that in attempting to assess a United States income tax on the dividend received by a nonresident alien stockholder from a foreign corporation, paid from the office of the foreign corporation in London, and the stock certificates not being held by a collection agent in the United States, the United States Government is arbitrarily going beyond the bounds of any recognized jurisdiction to tax nonresident aliens.

APPENDIX E

THE PAQUET-HARANA, 175 U. S. 677 (U. S. SUPREME COURT, JAN. 8, 1900)

This case involves the right to capture as a prize a fishing boat engaged in coastal fishing. It was contended by the owners that such boats engaged in coastal fishing were not subject to capture, as boats engaged in commerce under international law. The Supreme Court held that the United States courts are bound to take jurisdictional notice of international laws in determining the property rights of nonresident aliens. The Court stated (p. 700):

"International law is part of our law, and must be ascertained and administered by the courts of justice of appropriate jurisdiction as often as questions of right depending upon it are duly presented for their determination. For this purpose, where there is no treaty and no controlling executive or legislative act or judicial decision, resort must be had to the customs and usages of civilized nations; and as evidence of these, to the works of jurists and commentators who by years of labor, research, and experience have made themselves peculiarly well acquainted with the subjects of which they treat."

Mr. VINSON. How many stockholders are there in Employers' Liability Assurance Corporation?

Mr. GLEASON. Something over 6,000.

Mr. VINSON. Your brief referred to there being 6,000 nonresident aliens, and I wondered if all of the stock was owned by them.

Mr. GLEASON. There are very few Americans, and they are less in comparison to the alien shareholders.

Mr. VINSON. I am very much interested in the *Burnett* case, to which you refer, and I would like for you to append to your brief quotations from that case that bear upon this question of the Federal Congress to tax nonresident aliens on corporate shares, and, I take it, on bonds as well, where the physical situs of the personal property is beyond the confines of the United States.

Mr. GLEASON. In the *Burnett* case, as I understand it, the question was whether or not the United States could subject to the Federal estate tax the property of a British decedent, a nonresident alien at the time of his death, was not a resident of the United States, and who was not engaged in business in the United States, although at the time of his death he owned property consisting of securities, including bonds, of the foreign corporation and bonds of the domestic corporation and stocks in the foreign corporation.

Mr. VINSON. I understand that is contained in the appendix.

Mr. GLEASON. The court's opinion, as I understand it, was based entirely upon three points.

The court recognized that the power or the jurisdiction of the United States to tax a nonresident alien must depend upon one of three factors, and that power only existed if one or more of the three factors were present, and those three things are these: Citizenship—and, of course, that could not be a nonresident alien—

but in order for the United States to tax there must be citizenship or residence in the United States. That is one thing. In the second place, there must be ownership of property in the United States; and, in the third place, there must be a carrying on of activities within and under the protection of the United States.

Mr. VINSON. What I am asking you to do is to file with your brief quotations from the *Burnett case*, so that we may have them for reference.

Mr. GLEASON. I will be very glad to do that.

Mr. McCORMACK. As I understand this now, under that 50-percent provision of the law adopted in the 1934 Revenue Act, any foreign corporation doing business in the United States, with 50 percent or more of its gross income in the United States, must withhold all dividends declared, whether earned here or earned abroad.

Mr. GLEASON. Four percent.

Mr. McCORMACK. They must withhold that portion of the dividends declared which are earned abroad?

Mr. GLEASON. Yes; and if, within 6 years after a company might do 50 percent of its gross business here at a loss and the other 50 percent of its business abroad at a profit, and pay a dividend out of the profit abroad, yet our statute says that the entire income from this corporation comes from the sources within the United States; and the Internal Revenue Bureau has ruled, quite contrary to what we think this committee intended, that we must withhold 4 percent of the entire dividend paid to individuals, nonresident aliens, and 13 3/4 percent of the dividends paid to nonresident alien corporations.

Mr. VINSON. The statute does not say the income must be derived from sources within the United States, but it puts a corporation that does more than 51 percent of its business here in the same category as a corporation that derives its income here.

Mr. GLEASON. That is right, as I understand it.

Mr. McCORMACK. The result is the same.

Mr. GLEASON. Yes.

Mr. McCORMACK. As I understand it, your company feels that all insurance companies should be given the same consideration.

Mr. GLEASON. We feel very definitely that we ought to be in the 15-percent class, if that is where the other insurance companies are going to be.

Mr. HILL. And that that 15 percent be taxed upon corporate income only and not upon dividends paid to the nonresident alien stockholders.

Mr. GLEASON. Yes; and there are two cases. In the first place, we feel that the tax on the alien stockholders is illegal. In addition to that, we feel that it is very unfair because it is impossible, due to the red tape, to do anything about it; and in the third place, which is quite important, there is an extremely small amount of money involved.

So far as I know, with one exception this corporation is the only foreign insurance corporation affected, and the amount involved is extremely small.

As a matter of fact, if we were to go through the red tape the United States would get practically no tax, because all of our shareholders

with the exception of 113, get less than a thousand dollars from us; and the chances are, although I cannot say it definitely, that they get no other income from the United States.

In respect to the other part of your question as to why we should be treated alike—that is, like domestic corporations—we always have been. Why we should be treated like other foreign companies—we have been up to this 1934 act; and the subcommittee, and I think the committee, recommended an amendment to the 1934 act. This committee said in its report that foreign corporations should be treated alike and that dividends received from foreign corporations should be treated alike.

So the two points are that we feel we should not be discriminated against so far as domestic companies are concerned. We feel we should be treated like all other foreign companies, and we feel that we should go into the 15-percent class and that our alien nonresident shareholders should not be taxed, because we do not think they can be.

Mr. McCORMACK. The 22 1/2-percent tax was applied to American corporations declaring dividends to nonresident aliens. That is the purpose. You say, first, that there is an illegality there; and, second, so far as foreign corporations are concerned, the difficulty of administration. That applies to most corporations who earn money in the United States. That is true, is it not?

Mr. GLEASON. As to the domestic corporation that is, and of course it is perfectly proper to have such a tax, if that is what you think should be done, because the money is earned here, the dividend is declared here, and the nonresident shareholder of the domestic corporation has the right to collect his dividend here, and has the right to bring suit to get protection from the United States courts.

In the case of a foreign corporation, with its main office abroad, and dividends declared abroad, the nonresident alien shareholder has the right only to go into foreign courts to get that. So the United States is giving no protection to the nonresident alien shareholder.

Mr. HILL. Of a foreign corporation?

Mr. GLEASON. Of a foreign corporation. That is, there is a definite distinction, a definite legal distinction. The foreign corporation is here; it does its business here, and you are perfectly right and justified in taking a tax from it here. But there you must stop, and we believe because you have no jurisdiction over the nonresident alien shareholder, nor do you have any jurisdiction over the money when it changes its identity from the United States income to the money of the foreign corporation.

Mr. McCORMACK. Is your company organized to operate under the laws of all the States with reference to reserves?

Mr. GLEASON. Yes, sir.

Mr. McCORMACK. Can you send any money abroad unless you have the permission of the Insurance Commissioner?

Mr. GLEASON. No; we cannot send a dollar without the approval of the Superintendent of Insurance.

Mr. McCORMACK. What superintendent of insurance?

Mr. GLEASON. The New York Superintendent of Insurance.

Mr. VINSON. You do not make the point that we do not have the power to withhold the tax on dividends in a domestic corporation,

even though the shareholders are nonresident aliens, and the evidence of their ownership is beyond the jurisdiction of the United States?

Mr. GLEASON. No, sir; I think you very definitely have that right because the dividend is declared here.

Mr. HILL. As I understand it, you are making the contention that we have no legal jurisdiction to impose a tax upon a nonresident alien, as to the dividends received by that agent from a foreign corporation?

Mr. GLEASON. That is right.

Mr. DINGELL. I would like to ask the witness a question or two. We have observed that there has been a great amount of gold coming into this country. This may be a little foreign to what you have in mind, but I know you have made a very extensive study of that subject, and I am wondering if you can tell us, or have available any facts or figures as to the amount, and as to the number of nonresident alien stockholders and bondholders in the United States; and also if you can tell us how many American stockholders and bondholders there are in foreign corporations. Have you any information of that kind available that might be put in the record in this connection?

Mr. GLEASON. I am sorry I have no such information, but Mr. Higgins tells me he understands the Department of Commerce is making such a study now.

Mr. DINGELL. There is nothing available that you know of?

Mr. GLEASON. No, sir.

Mr. DINGELL. I am wondering if the Commissioner of Internal Revenue has any knowledge in that connection.

Mr. Commissioner, has your bureau any thing of that sort available?

Mr. HELVERING. We are making a study of that in conjunction with the Department of Commerce at the present time.

Mr. DINGELL. But there is nothing available that could be inserted in the record at this time?

Mr. HELVERING. I could not give you anything now.

(Thereupon a recess was taken until 2 o'clock p. m.)

AFTERNOON SESSION

The recess having expired, the committee reconvened at 2 p. m., Hon. Robert L. Doughton (chairman) presiding.

The CHAIRMAN. The committee will be in order. While he is not listed on the calendar as the next witness, I am informed that Commissioner Helvering would like to make a brief statement. Without objection, he will be recognized at this time.

FURTHER STATEMENT OF HON. GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

Mr. HELVERING. Mr. Chairman and gentlemen, a request was made a few days ago by the gentleman from Ohio, Mr. Lamneck. I thought, Mr. Chairman, that in my opening statement, I had endeavored at least to make a very fair presentation, but Mr. Lamneck

charged me with being willing to give certain facts to support the bill, but unwilling to give information that might not support it. And he challenged me to show the number of partnerships that had incomes of \$500,000 or more.

I want to ask the privilege of putting in the record two tables, one showing the total number of partnerships reporting net income in the year 1935 and the brackets in which they run, from \$100,000 up.

I might say in explanation that this information was received by telegraphic reports from collectors of internal revenue throughout the United States, on the reports filed for the year 1935, which were filed just this last March.

The total number of partnerships making income-tax returns was 205,432. Those under \$100,000 numbered 178,419. Those over \$100,000 numbered 833, with a total income reported by the partnerships of \$1,159,277,943.76.

In the classification \$100,000 to \$200,000 there were 552 making returns, with a total income of \$76,152,151.47, an average net income of \$137,956.79.

Those with incomes of \$200,000 to \$500,000 numbered 201, with a total income of \$57,219,773.87, or an average net income of \$284,675.49.

Those with incomes between \$500,000 and \$1,000,000 numbered 57, with a total income of \$37,609,518.68, or an average net income of \$659,816.11.

Those with incomes over \$1,000,000 numbered 23, with a total net income of \$42,635,244.98, or an average net income of \$1,853,706.30.

May I put these two tables in the record?

The CHAIRMAN. Without objection, they may be incorporated in the record.

(The tables referred to are as follows:)

Partnership returns filed for year 1935 showing net income \$100,000 and above

Bracket	Number of returns	Total net income	Average net income
\$100,000 to \$200,000	552	\$76,152,151.47	\$137,956.79
\$200,000 to \$500,000	201	\$57,219,773.87	\$284,675.49
\$500,000 to \$1,000,000	57	\$37,609,518.68	\$659,816.11
Over \$1,000,000	23	\$42,635,244.98	\$1,853,706.30
Total	833	\$213,616,689.00	\$256,442.00

Partnership returns filed for 1935

	Number of returns	Total net income
Under \$100,000	178,419	\$945,693,254.78
Over \$100,000	833	\$213,616,689.00
Total	179,252	\$1,159,277,943.76
Less:	36,180	\$7,012,154.46
Total	205,432	\$1,072,265,889.30

Mr. LAMNECK. What sort of concerns were these 23 with incomes of over a million dollars? What business are they in?

Mr. HELVERING. All sorts of business.

Mr. LAMNECK. Manufacturing business and retail business?

Mr. HELVERING. Well, I do not know as to that.

Mr. LAMNECK. Are they not all lawyers or professional men, types like that?

Mr. HELVERING. There may be a great number of them which are brokerage concerns and law concerns, but I do not see that that makes any difference in my illustration.

Mr. LAMNECK. That is all.

Mr. COOPER. May I ask the Commissioner a question? Mr. Commissioner, I understood you to say that you had secured this information in the form of telegrams from collectors throughout the country and compiled the totals from that information?

Mr. HELVERING. Yes, sir.

Mr. COOPER. Very well.

The CHADMAN. The next witness is David Stock, of New York.

Mr. Stock, would you give your name and address and the capacity in which you appear?

STATEMENT OF DAVID STOCK, ATTORNEY, NEW YORK CITY

Mr. STOCK. My name is David Stock, 170 Broadway, New York City.

The CHAIRMAN. How much time will you require?

Mr. STOCK. About 10 minutes.

The CHAIRMAN. You are recognized for 10 minutes.

Mr. STOCK. Mr. Chairman and members of the committee:

I am heartily in favor of what I conceive to be the principal purpose of the legislation proposed by your subcommittee, or, in any event, what I believe will be its principal effect in operation.

It will, insofar as the historical glorification of the corporation and its deep-rooted fictions permit, tend to do away with the present duality of taxes on corporate income; that is, the initial tax on the corporation and the subsequent surtax on the recipient stockholders. This will be in the direction of bringing our underlying concept in line with that of England and practically every other large country, where the corporate tax is essentially one on undistributed income.

In my opinion it will go a long way to force payment by wealthy stockholders at the time that their investment produces the income and not at some subsequent time when those in control of the corporation may decide to distribute the corporate income. I need merely remind you of the war and post-war period when inordinate corporate surpluses were dammed up in the hope and expectation that individual surtax rates could be lowered to release them.

It is my firm conviction that the opposition to your bill is prompted by the same motive. I mean that large corporations are beginning to make money again, and those in control of those corporations look for another period of large profits. They don't want to pay the existing individual income tax rates on the distribution of such corporate shells until such a time as a hoped for new administration, more amenable to their views in this regard, will lower the

individual rates, precisely as was done in the Harding Administration I believe.

With your permission I should like to address myself briefly to the principal arguments of the opponents of this proposed legislation.

First of all, we can, with contemptuous dispatch, dispose of the assiduous and subtle methods of those who know, or ought to know, the structure of this tax, to instill the fear that this will be a tax on accumulated surplus. The Hearst papers this morning carried a front page headline "Surplus Tax Hit as Monopoly Aid." Even the usually conservative David Lawrence has not been so conservative in the way in which he has handled this matter. This propaganda has had its effect and will be one of the most difficult elements of the opposition to overcome. Almost all of the business men with whom I have discussed this legislation seem to labor under the mistaken and fearful impression that it is a tax on accumulated surplus which will now have to be unscrambled in some way. This is a tax on undistributed income. It is not a tax on surplus and never will be, Mr. Hearst and the others to the contrary notwithstanding.

Now, as to the arguments that such a tax will prevent the building up of working capital and surplus in good times and the continuance of dividends in times of depression, with all sorts of dire predictions. Congress and this committee are not, I should think, unaccustomed to immoderate statements and dire predictions from Wall Street.

What are the facts? The ultimate realities in the life of a corporation are earnings and cash. These will prevail, no matter how much bookkeeping and juggling is indulged in. Surplus, on the other hand, is, as everyone experienced in the history and methods of corporate finance knows, a very plastic something which may, or may not, reflect what it is supposed to. Stated without refinements, it is supposed to be the excess of the real value of the corporate assets over the aggregate of capitalized owned and borrowed capital. Actually, it is a bookkeeping arrangement which reflects anything that legal and financial device and ingenuity wish it to be.

The very people who are now talking about the impairment of that surplus by this proposed tax have increased it and decreased it at will by a number of devices, the mere relating of which would take more time than is available to me. When surplus has been too large, in their opinion, so as to present a tax vulnerability, they devised the stock dividend and rights, which capitalized part of the surplus. When it has been too small, in their opinion, they have increased it by issuing no par stock with a stated value of only a small portion of the paid-in capital; they have increased it by conversion of bonds into stock of no par value or par stock of a stated value, less than the face amount of the bonds; they have written in and written up assets; they have reduced the par value or the number of shares of stock.

As far as surplus is concerned then, if a corporation has sufficient cash, the question of surplus will present no insurmountable obstacle to the declaration of dividends in time of depression. Those who run the large corporations will, as they have in the past, tailor the surplus to the purpose.

It takes cash, however, to pay dividends. If this proposed tax is paid with corporate cash, how will the corporation maintain or replenish its cash position?

I will speak first of what I would call the Investor Corporation—that is, the corporation that has invited the investment of funds by outsiders as contrasted with the closed corporation of one man or one family or a few individuals.

It is safe to say, I believe, that the average investor corporation has received more cash from investors than it has from undistributed profits. And in my opinion the continuing ability of an investor corporation to obtain such cash is greater in the case of a corporation that pays substantial cash dividends to its investors. Taking the American Telephone & Telegraph Co., the example which the opponents of this proposed tax seems to favor, there can be no question that the unequalled ability of this corporation to obtain cash from investors is derived from its excellent dividend record. The American Telephone & Telegraph Co., could if it wanted to today, obtain many times the cash which it now has by issuing additional stock.

Mr. VINSON. Will the gentleman yield on that point?

Mr. STOCK. Yes.

Mr. VINSON. May I suggest, on that point, that between 1921 and 1930 the net income reported by the American Telephone & Telegraph Co. was \$1,169,000,000; that cash dividends paid during that period were \$854,000,000; that earnings carried to surplus during that period were \$315,000,000; and during that same period the American Telephone & Telegraph Co. raised from stockholders through the issuance of stock rights, \$958,000,000; or, in other words, \$104,000,000 in excess of the cash dividends paid.

I submit those figures as Treasury figures.

Mr. HILL (presiding). You may proceed, Mr. Stock.

Mr. STOCK. As for the closed corporation, consisting of one man or one family or several individuals, I can see no reason why such a corporation should receive any different treatment as far as taxes are concerned, than a partnership or any other form of business organization in which the fiction of a separate corporate entity does not exist. Presumably, the owners of such a corporation will be willing to place their dividends back in the corporation; if not, that is their choice.

In conclusion, I would like to address myself briefly to two other arguments that the opponents to this legislation have advanced.

They claim that the distribution of cash dividends, that would presumably be induced by such a tax, would induce undue speculation by the recipients thereof. This argument would seem to come with bad taste from large corporations that contributed very actively in such speculation by the use of unnecessary corporate cash in the call market.

It is difficult for me to understand why these corporations should be so solicitous about the supposed irresponsibility of the recipient stockholders. Maybe such stockholders will see fit to save their money against a rainy day, so that they will not have to look to large dividends from corporations in time of depression, or should they

see fit to reinvest the cash in other corporations they will presumably, in time of depression, receive dividends from such other corporations in addition to the dividends from the corporations from which they received cash which they so invested.

In any event, it will give the stockholder the opportunity to decide what he wishes to do with the income from his investment—at least to the extent that such cash is not needed by the corporation and which should by all rights be distributed to him. As to cash which the corporation must retain for its corporate purposes, I can see no cogency in the argument that such a tax will induce the distribution of such cash. A management which distributed such cash, in order to save the tax, contrary to its better judgment as to the cash requirements of the corporation, would be abusing its power, and I am not impressed with an argument that argues the abuse of a function.

In conclusion, I believe that the business life of the country will readily adjust itself to this proposed tax and that the various interdependent elements will seek their proper level.

Mr. TREADWAY. Are you here in the interest of anybody but yourself as a taxpayer?

Mr. STOCK. May I state the reason I am here? I had occasion to hear Mr. Boake Carter make a speech on the radio one evening, and I wrote him a letter criticizing his speech. That letter was sent to the Treasury.

Mr. TREADWAY. Whom are you referring to?

Mr. STOCK. I say, a radio commentator made a speech on the radio one evening, which I heard, on this tax bill. I wrote him a letter in which I pointed out what, in my opinion, tended to give a false impression of the purpose of the bill. He sent that letter on to the Treasury. The Treasury communicated with me and asked me if I would care to state my views before this committee. That is why I am here.

Mr. TREADWAY. Are you a business man or a lawyer?

Mr. STOCK. I am a lawyer.

Mr. TREADWAY. Are you counsel for any corporation?

Mr. STOCK. No; I am not. I am associated with a firm that is counsel for many corporations.

Mr. TREADWAY. So you are here at the request of the Treasury?

Mr. STOCK. That is correct.

Mr. TREADWAY. You made some reference there to Mr. David Lawrence.

Mr. STOCK. That is correct.

Mr. TREADWAY. About not agreeing with his views.

Mr. STOCK. No; I did not want to give that impression. I think he was a little careless in his writings, which I think would tend very clearly to give the average reader the impression that this imposed tax is a tax on accumulated surplus. I do not think any intelligent writer—

Mr. TREADWAY (interposing). Do you know Mr. Lawrence by reputation?

Mr. STOCK. I do, very well; and I have a high admiration for him.

Mr. TREADWAY. Do you think that he would be holding the position

that he does in writing for syndicates and writing books, and all that sort of thing, if he was careless, as you say, in his statements?

Mr. STOCK. I still insist that in that respect he has been careless. I say that any intelligent writer who speaks of this as a tax on surplus is careless.

Mr. TREADWAY. Of course, we are not obliged to agree with your findings.

Mr. STOCK. Of course; I am only expressing my opinion.

Mr. TREADWAY. I would like to ask you a little more about what Mr. Lawrence did say. I read Mr. David Lawrence's statements. I do not always have to agree with him; we do not, any of us, always agree. But when a witness comes before this committee and tells us that a man with Mr. David Lawrence's position in the journalistic world would either try to carry such an impression to his readers—

Mr. STOCK. I did not say that, Mr. Congressman.

Mr. TREADWAY. Or be careless in the way in which he uses language, I think you ought to qualify yourself as an expert pretty well in the judgment of men when you make any such statement as that.

Mr. STOCK. May I say a word about that, Mr. Congressman?

Mr. TREADWAY. Certainly, I would like to have your explanation. I would like to see the language that you objected to.

Mr. STOCK. I wish I had the article with me.

Mr. TREADWAY. I wish you did. We agree there absolutely.

Mr. VINSON. Will you put the article in the record?

Mr. STOCK. I think it appeared last night.

Mr. VINSON. Just put it in the record at this point.

Mr. STOCK. Yes, sir.

(The article referred to is as follows:)

[Washington Star, Apr. 8, 1936]

SURPLUS GUARD AGAINST COLLAPSE

PROPOSED TAX DEEN LIKELY TO BE MAJOR CAUSE IF DEPRESSION RETURNS

By David Lawrence

To the reader who believes that panics are inevitable in cycles of 5 to 7 years or more, because they represent the sum total of human error in attempting to measure the future, there are many factors now in operation, any one of which will doubtless be singled out some day as the conspicuous cause of the next depression.

Just which one will be selected for emphasis is, of course, impossible to conjecture, but it seems possible, and indeed distinctly probable, that the undivided surplus tax, if enacted into law as a basis of American tax policy, will be a major cause of the next economic collapse experienced by the United States.

Testimony is piling up that a tax on surpluses or a penalty on foresight is bound to bring in its wake more distress than followed the panic of 1929 because the severity of the current depression was immeasurably reduced by the large reserves which had been hoarded for the emergency.

\$50,700,000,000 DIVIDENDS

The latest reliable figures show, for instance, that in the 13 years between 1923 and 1935 dividends amounted to \$50,700,000,000, as against \$41,000,000,000 of net income for that period. In other words, all the net income for the 4 years from 1929 to 1933 was expended to meet dividend requirements and

\$9,700,000,000 of income from previously accumulated surpluses was disbursed as well. In addition, about \$10,000,000,000 was disbursed out of surpluses to meet deficits, and particularly pay rolls. What would American industry have been able to do had there been no such surpluses? What would have happened to the American financial structure if the dividends that were paid had been stopped altogether? Businessmen answer, that without surpluses set aside each year and without the purchasing power and investment funds furnished by dividends in depression, many a company would have been wrecked, its employees forced out of employment and the capital invested would have been lost.

To force a disbursement of dividends when sound management would seem to indicate that just the reverse policy is essential, means that the responsibility for determining the future of American business may rest squarely on Government and not on the managers or stockholders or owners or partners as the case may be.

The last panic was blamed on Wall Street—the next one may be blamed on the tax policy of Government.

COST OF SURPLUS

One important business has figured it out that to retain a surplus will cost about 40 percent. It can get capital much more reasonably by borrowing, but this, fortunately, is because the company in question already has a surplus which presumably will not be taxed. So it will be in a position to borrow new money and will, of course, distribute its surplus in dividends rather than pay the penalty tax.

But the other type of business which has no accumulated surplus will borrow with difficulty and if it does get credit it may be among the first to collapse at the first adverse turn in a business tide. This is because its opportunity in good times to build up a surplus to take care of annual sinking fund requirements will be impeded by the new tax policy of the Government.

But what will be the plight of companies that have distributed surpluses and who find a sudden need for capital when business turns downward? The opportunity to borrow funds when all corporations want it may be affected by tight money conditions or by psychological factors. It is to avoid precisely this kind of a situation that reserves are built up, so business will have funds to weather a storm.

Perhaps the most amazing aspect of the tax situation is that no bill has been written as yet by the House Ways and Means Committee. Hearings are being held on an academic or theoretical basis. The exact wording of the law, the supposed amendments to protect certain types of companies in the banking and insurance field have not been revealed. The hearings being held are perfunctory and will have to be duplicated when the exact phraseology of the proposed bill is known.

HEARINGS ON IMAGINARY BILL

Many things of an unprecedented and revolutionary character have been done by the New Deal party, but nothing quite so novel as to hold hearings on an imaginary bill whose only outline has been presented in a presidential message and in a vaguely worded report of a House subcommittee. Undoubtedly the Senate Finance Committee will hold hearings, too, but in the meantime business uncertainty multiplies and the financial managers of America's enterprises do not know how they must adjust themselves to the new tax changes.

Assuredly the income tax in 1913 was a profound influence upon the conduct of American business. But with the size and scale of operations today the proposed tax on undivided surpluses is bound to cause an even greater transformation in methods and practices, and some day, when the nonsurplus system faces a real test of economic adversity, the Nation will be able to examine in retrospect the far-reaching influence of the devastating attack now being made on the policy of thrift and foresight in accumulating a surplus for a rainy day. The proposed tax is tantamount to saying, "The rainy days will never come again." But, unhappily, they do come, and years after the persons responsible for the policies that brought them on are out of office, and hence immune from reprisals at the polls.

Mr. TREADWAY. You say the article appeared last night?

Mr. STOCK. Yes.

Mr. TREADWAY. Where?

Mr. STOCK. In the Star.

Mr. TREADWAY. The article that you are finding fault with?

Mr. STOCK. Yes, sir.

Mr. TREADWAY. Wherein he was careless?

Mr. STOCK. In my opinion. And I think I have stated the basis of my opinion.

Mr. TREADWAY. You say that that article evidently insinuated that the impression was going around the country that this bill was a tax on accumulated surplus?

Mr. STOCK. That is correct.

Mr. TREADWAY. Back surplus?

Mr. STOCK. That is correct.

Mr. TREADWAY. Now, that has been stated, Mr. Stock—time and time and time again in the press—that it was to be a tax on future surplus and that it had nothing in the world to do with what has been in the past accumulated. Now, I cannot believe, even on your word, that Mr. Lawrence even intimated in any article that he wrote any such thing or made any effort to deceive the public in what he was saying.

Mr. STOCK. I did not say that.

Mr. TREADWAY. Even to the extent, perhaps, as we often all of us do, use language carelessly, as you said.

Mr. HILL. Will the gentleman yield?

Mr. TREADWAY. Certainly.

Mr. HILL. I believe the gentleman from Massachusetts used the word future surplus. Would it not be better to say future earnings?

Mr. TREADWAY. Originally it was surplus, and eventually we got this changed to income or profit; and when we get a bill the Lord knows where we will be. At any rate, it is a very changeable proposition. You certainly would not claim, Mr. Hill, anything but that originally the Treasury advocated a tax on future surplus and then—

Mr. HILL. Future earnings.

Mr. TREADWAY. Future earnings in the form of surplus, and then you changed the language, or somebody did, all around.

Mr. HILL. Future net income.

Mr. TREADWAY. Yes; future net income. But there is one other point. You were referring to corporations that raised or lowered their surpluses at will.

Mr. STOCK. Yes, sir.

Mr. TREADWAY. Do you think any corporation of business standing would do that sort of thing, intentionally, to deceive either their own stockholders or the public or their customers?

Mr. STOCK. Well, Mr. Treadway, that is a kind of a double-barreled question. If you will separate it, I will be glad to answer it.

Mr. TREADWAY. Separate it any way you want. I am only asking the question on the basis of what you said.

Mr. STOCK. As to the first question, whether they have done it, I would say they have done it very frequently.

Mr. TREADWAY. For the purposes of deception?

Mr. STOCK. As to the purpose, I cannot search their minds. I can only judge their objective activities, you see.

Mr. TREADWAY. Would it not be well for you to be a little bit informed?

Mr. STOCK. Well, I have been a close student of corporation finance for 15 years.

Mr. TREADWAY. I am afraid that it has only been theory and study rather than practical financial experience.

Mr. STOCK. May I, in my own defense, Mr. Treadway, tell you that I was chosen by the American Bankers Association in 1932 to write a book on corporation finance for the American Bankers Association.

Mr. TREADWAY. Then you are an expert on finance?

Mr. STOCK. I do not think those gentlemen are theoretical.

Mr. TREADWAY. The bankers are not?

Mr. STOCK. I do not think so.

Mr. TREADWAY. No; I will admit that.

Mr. VINSON. Now, having settled that—

Mr. TREADWAY. Settled nothing. The gentleman has not settled anything, so far as I can see, in the way of supporting his argument that corporations will back and fill and rearrange their figures to suit themselves.

Mr. STOCK. May I cite you one prominent example of what I have in mind? That is the Dodge Automobile Co., as an example of increasing surplus by the device of no-par stock. And may I recommend to you a book called Main Street and Wall Street by Mr. Ripley, that I believe would give you dozens of such prominent examples of the same practice.

Mr. TREADWAY. I noticed another thing, that the gentleman from Kentucky [Mr. Vinson] was very glad to help you out in connection with your reference to the American Telephone & Telegraph Co. I notice he did not have anything to offer you in the way of suggestions as regards their accumulated surplus or stock dividends or rights that they have disposed of in the last few years. He only carried that up to 1931 or 1930, did he not?

Mr. STOCK. They stopped in 1931.

Mr. TREADWAY. Oh, they did? Well, what have they done in the way of paying dividends since then?

Mr. STOCK. I think I can explain that, Mr. Treadway.

Mr. TREADWAY. Good.

Mr. STOCK. Up until 1931, the American Telephone & Telegraph Co. had an annual building requirement of some four to five million dollars, by virtue of expansion, alterations, and so forth. After 1931, as a result of loss of telephone stations, they curtailed that building program very sharply. The result has been this: They have approximately 5 percent per year depreciation charge against roughly \$5,000,000,000. That charge is almost twice the annual retirement for replaced equipment. The result has been that they have had over a hundred million dollars a year of cash coming into the corporate treasury by virtue of the unused depreciation charge.

In my opinion, the cash which they have been paying in dividends since 1931 has been coming out of that cash which they have not needed.

Mr. TREADWAY. Out of what? Out of the charge for depreciation?

Mr. STOCK. That is correct.

Mr. TREADWAY. That they have not used?

Mr. STOCK. That is correct.

Mr. TREADWAY. What does the Internal Revenue Bureau have to say about that?

Mr. VINSON. What business is it of the Internal Revenue Bureau, Mr. Treadway?

Mr. STOCK. There is no tax problem involved there.

Mr. TREADWAY. What about the depreciation that you say that they have charged on their books, and that they did not actually have?

Mr. STOCK. That is a set-up of reserves for future requirements, you see, which is reflected in cash which is not now being used, but which will presumably some day have to be used.

Mr. TREADWAY. In other words, do I understand you to say that in the last 5 years the American Telephone & Telegraph have not gone into their surplus account?

Mr. STOCK. Of course they have.

Mr. TREADWAY. To keep up their dividends?

Mr. STOCK. Yes; the dividend payments have been reflected in the reduction of surplus, but they have had to pay those dividends in cash, and that cash has come from the fund which I speak of.

Mr. TREADWAY. That does not affect the fact that they did not earn the dividends?

Mr. STOCK. They did not earn the dividends; no.

Mr. TREADWAY. They kept up the dividends for the benefit of their stockholders?

Mr. STOCK. Yes.

Mr. TREADWAY. Well, we agree on that; thank you.

Mr. VINSON. Of course, the point illustrated by my reference to the American Telephone & Telegraph Co. was that during the fat years, 1921 to 1930, even though they declared in dividends \$854,000,000, they recovered back from the sale of stock rights \$104,000,000 over and above that, or a sum total of \$958,000,000. So that they would never get caught at the maximum rate of tax as applied to moneys retained.

Mr. STOCK. Mr. Vinson, I might say that the American Telephone & Telegraph Co. could never have kept up with its building requirements if they had not been able to raise cash in the way you indicate.

Mr. REED. Were you invited by the Treasury to come here by telephone or by letter?

Mr. STOCK. By telephone.

Mr. REED. Are your expenses being paid by the Treasury?

Mr. STOCK. No; they are not. I am here on my own business.

Mr. REED. You have clients who are interested in this bill?

Mr. STOCK. Not a bit.

Mr. REED. You are just lobbying for the Treasury at the present time?

You need not answer that if you do not want to.

Mr. HULL (presiding). If there are no further questions, thank you, Mr. Stock.

The next witness is Mr. Frank H. Hall, of New York.

STATEMENT OF FRANK H. HALL, NEW YORK CITY, DIRECTOR AND GENERAL COUNSEL OF THE CORN PRODUCTS REFINING CO., AND REPRESENTING ALSO THE CORN REFINING RESEARCH FOUNDATION

Mr. HULL. Mr. Hall, state your name and the capacity in which you appear.

Mr. HALL. My name is Frank H. Hall, 17 Battery Place, New York City, director and general counsel of the Corn Products Refining Co.

Mr. HULL. And you are appearing here on behalf of that company?

Mr. HALL. Of that company and the Corn Refining Research Foundation.

Mr. HULL. How much time would you require for your statement?

Mr. HALL. About 10 minutes.

Mr. HULL. You are recognized for 10 minutes. Please proceed.

Mr. HALL. Mr. Chairman and gentlemen, I want to speak only with relation to that part of the proposed tax bill which is referred to in section 24 of the subcommittee report, particularly on page 9. That is the windfall tax. That sentence on page 9 reads:

The selling price should be adjusted by the deduction of any amounts subsequently repaid to the purchaser, on or before March 3, 1936, or pursuant to a bona fide written contract entered into on or before March 3, 1936, as reimbursement for the amount included in the price on account of the excise tax.

I am really speaking in behalf of the second class of concerns mentioned in the beginning of section 24.

Dealers who included the amount of a Federal excise tax in the price of goods sold by them but who were subsequently reimbursed by their vendors for the amount of the tax.

Immediately following the decision of the United States Supreme Court on the constitutionality of the A. A. A., the corn refiners sent to the press or released to the press and sent out to the trade the following notice:

The Corn Industries Research Foundation announces today that 10 corn-refining companies who have tax refunds coming to them as a result of the decision of the Supreme Court, invalidating the Agricultural Adjustment Act, have advised the foundation that their companies neither desire nor intend to derive any profit from the return of these taxes, and that it is their intention that these refunds shall be passed on to their customers just as soon as the way is legally clear and the necessary preliminary computations and adjustments can be effected.

Says the foundation: "The burden of processing taxes in general was borne by the ultimate consumer, and this industry would feel itself unjustly enriched unless it attempted, to the best of its ability, to restore these taxes to the people who actually paid them."

The following corn refiners are members of the foundation:

American Malze Products Co.
Anheuser-Busch, Inc.
Clinton Co.
Corn Products Refining Co.
The Hubinger Co.
The Huron Milling Co., Inc.
The Keweenaw Starch Co.
Penick & Ford, Ltd., Inc.
Piel Bros. Starch Co.
A. E. Staley Manufacturing Co.
Union Starch & Refining Co.

Under date of February 4, 6, and 10, three of the companies interested in the industry sent notices to the entire trade. One of those contained this clause:

There has been some discussion about Congress passing a retroactive excise tax which would oblige us to pay these refunds over to the United States Government. There is some uncertainty concerning the regulations of the Treasury Department in connection with the income-tax laws.

It may be some time before we will know definitely that we are free of the possibility of having to pay all or a portion of these refunds to the Government. We are, of course, hopeful that these uncertainties will be eliminated by the time our computations are completed.

In a second letter to the trade, there was this paragraph:

As you have doubtless seen in the public press, various proposals are being made in Washington which include the possibility of the levying of a retroactive excise tax equivalent in amount to the invalidated processing taxes. If Congress should put into effect this, or a similar proposal, then the fund which we now hold would have to be paid to the United States Government, and not to our customers. It follows that the distribution of the fund must await the time when we can determine with reasonable certainty the action which Congress may take. Obviously, it would be unreasonable to expect that we should distribute this fund to our customers so long as we are threatened with the possibility of having to repay the fund to the United States Government.

The first of those letters went out February 4 and the second February 6. On February 11, our own company sent this letter to its entire trade:

NEW YORK, N. Y., February 11, 1936.

Re: Refund of processing taxes.

To Our Customers:

In order to be prepared to promptly comply with the announced policy of our industry, this company is now engaged in computing the adjustments due our customers on account of the processing taxes previously impounded by the court and now returned to us or withheld from payment.

We can be greatly assisted in this work if our customers will promptly furnish us with the dates and numbers of our invoices covering goods shipped them between July 31, 1935, and January 7, 1936.

Do not include invoices covering crude or refined oil, hydrol, or feed, as the tax on these items was absorbed by the manufacturer and was not included in the price.

Yours very truly,

CORN PRODUCTS SALES CO.,

Accounting Department.

On March 3, I have a copy of a letter here which I sent to a number of our customers in response to demands, "Why don't we get the money? It is safer in our hands than yours." And I would like to read from that letter:

Our company is now engaged in preparing to make distribution of these refunds, but feels, in view of the announced policy of the administration and the tax laws proposed to be submitted to Congress that we cannot actually make any of these refunds until we know more definitely the final action to be taken by the Senate and the House of Representatives on this matter.

We sincerely hope that no legislation will be enacted which will prevent our paying over the recovered taxes to those of our customers who we feel should be entitled to receive the refunds and who we expect, in turn, will account therefor to their customers in those cases where the tax was reflected in their prices.

Briefly, then, gentlemen, I am only speaking to the limitation which the subcommittee has recommended, that credit be allowed in

connection with the "windfall" tax for any refund which the processor may have made to his customer prior to March 3, 1936, or pursuant to a written contract made prior to that date.

In other words, if you will take the description of the dealer which appears in the first part of this paragraph of the subcommittee's report, the dealer who included the amount of the Federal excise tax in the price of goods sold by them, but who were subsequently reimbursed by their vendors for the amount of the tax, and no matter when they were reimbursed, permit the processor to satisfy his trade, if his trade did pass the tax on in the price, he, in turn, to make a report and account for it.

I trust I have made the point clear, gentlemen. I am only speaking of the limitation that, as things stand now, in case a processor has, prior to March 3, repaid his customers whatever tax he may have recovered by virtue of the decision of the Supreme Court, that is passed, and this "windfall" tax does not apply.

In our industry we promised the money to our customers, but in an excess of caution, perhaps, waiting to see what the legislation would be, we have not yet paid it off but have set it aside in a fund. We promised it to our customers, and we ask you to give us the same opportunity to refund it to them.

Thank you.

Mr. COOPER (presiding). We thank you for your testimony and the information you have given the committee, Mr. Hall.

According to the calendar, Mr. Louis Sucher, of Dayton, Ohio, is the next witness. I notice on the chairman's calendar that he has been marked off; and I assume that the next gentleman, Mr. Welhener, of Dayton, Ohio, will speak for himself and Mr. Sucher. I assume, Mr. Welhener, you are appearing for both?

Mr. WELHENER. No. Our problems are similar, so I thought one of us would speak to you and give you our views. Our views coincided.

Mr. COOPER. We appreciate that consideration that you have given the committee and we are glad to hear you.

STATEMENT OF CARL F. WELHENER, REPRESENTING THE HENRY BURKHARDT PACKING CO., DAYTON, OHIO

Mr. COOPER. You are listed, both of you, as representing the same concern.

Mr. WELHENER. I would have to say that I was speaking principally for ourselves, although Mr. Sucher, I think, concurs in my views on some of these things. We talked things over this morning, to be frank about it, and he said, "That is according to my ideas", so I am appearing to present those ideas.

Mr. COOPER. Please give your name and address and the capacity in which you appear for the record and so that the members of the committee may hear you.

Mr. WELHENER. My name is Karl F. Welhener. I live in Dayton, Ohio, and I am here as a representative of the Henry Burkhardt Packing Co. of that city.

Mr. COOPER. How much time do you think you will need?

Mr. WELHENER. Not much, just a few minutes—10 or 12 minutes.

Mr. COOPER. You are recognized for 10 minutes.

Mr. WILHEMER. I want to say that I am not here as a lobbyist or as an attorney but as a working member of our organization.

I am here because, like others in our organization, we are deeply concerned about what the future holds for our business.

To give you just a little background or history, kind of leading up to the remarks that I want to make, I want to tell you a little about our business.

It was started in 1878 and grew, and in 1894 it was incorporated. It made a little money as it went along in different years, and it was plowed back into the business, as they say. Well, it went along and continued killing cattle and hogs and sheep and calves, under B. A. I. inspection, and we kept our heads above water during the depression period—worked under all the rules and regulations of the N. R. A. There were about 125 of us, and that was our means of livelihood.

We worked in a limited territory, necessarily, because we are a small concern. Our territory is very largely the southwestern part of Ohio, and the Ohio Members will recognize the line drawn, say, from Greenville through to Columbus and Gallipolis, and along the Ohio River and back around to the Indiana line.

A small concern like ours is governed very largely by the matter of truck facilities and we get into the matter of freight competition against competing firms.

I want to say that over all this time our company built up, through fair dealing and conservative management, some goodwill and a reputation that we prize rather highly, and we hate to see it destroyed. We are afraid of that thing, and that is why we are here to say a few words on our behalf, after we found out that this hearing was to be held.

I want to say that I believe that we are just a typical company, typical of hundreds of businesses throughout these United States.

Now, I should like to say that I think there is a misconception regarding the packing business. As a whole, it is a great big, huge industry. But you are losing sight of the fact that there are about 1,250 different concerns in the packing industry that are working along lines similar to the lines we are working along, some of them larger, some of them smaller, it is true.

It is a popular thing to criticize the big packer; and, after all, if you stop to consider it, there are only about 10 national concerns. By that I mean firms that really blanket the country. That leaves you with about 1,250 small units in this country that are engaged in the packing business. And I think I speak on their behalf when I say that we are all worried over the results of this bill.

I think most of these that I speak of, except the national concerns, operate similar to ourselves, in a restricted territory, where they can give service and meet competition.

We do not have any particular brief for the big packer, nor have we any particular fault to find with him. In fact, we are somewhat sympathetic, because we think his problems are the same as ours, only on a larger scale.

Now, this question about the claim that the tax was passed on to the consumer; I think that is one that we had better meet squarely, and, as we see it, we think we have an answer to that.

We could not go ahead and add, say, at the bottom of our invoice, 3 percent, using that figure to illustrate the case, and say that that represents the processing tax, because you might have a low-priced product and a high-priced product up there, and it would not be equitable to all to use such an arrangement.

And I will say right here that no accountant, nobody—not even the packer himself—if he came into the office, could turn to an invoice and say, "Show us where you added the processing tax or left it off."

That is a surprising statement, but we could not tell you. But the total of our hog operations is what counts. And I made that previous remark, because after you commence to cut up a carcass nobody knows its value. We worked on allocated percentages to arrive at values, or a hoped-for realization to determine whether we were making any money. But, to get to the point that we have got an actual cost, say that that pork loin cost \$19.23, that is a debatable question, and that is why I say that any competent accountant can come into our office and we can prove to his satisfaction that we lost money on our hog operations through the period of the processing tax.

If we had not been killing some cattle and sheep and calves, we would have lost more money than our books show. And for that reason it does not necessarily follow that some of these firms that published a statement showing the profits that they made, that they necessarily passed that tax on, because with their many activities and their huge operations, they made money on those that offset their losses on these hogs. And even the statements that come out are not particularly gratifying to them, I am satisfied, because they do not show such a huge percentage of profit on their investment, or their turnover.

I was going to say, in that connection, that there are reasons for this: That the tax could not be passed on, for instance. We ordinarily have a plant that could operate about 1,200 to 1,500 hogs a week. That is, that section of the plant, if we were working as we should be working. Instead of that, we gradually cut down on our operations until during 1935 my book here shows that we killed a little over 600 hogs a week.

What did that result in? It resulted in the fact that overhead expense—and I believe our overhead is small—was practically doubled. And the same thing is true of fixed charges of various kinds. They were doubled, either figuring per head or per hundredweight; and so on down the line.

And when you get into a practical operation, with those conditions, your work naturally slows up, and it is all costing you more money.

Then there is another point. Bear in mind that we are handling a perishable product from the time that we buy the live animal in the stockyards until that fresh product is moved; even taking lard or provisions in our cellars, because in time they become perishable when they reach a certain point and are not taken care of.

What I am getting at particularly is the fresh stuff that had to be moved regardless of cost or any other consideration. It had to be moved at the market, and it is unfortunate that we are not large enough to make the market, because the market is made on livestock, on account of the reduced amount of livestock that was in the market,

on hogs particularly. The price went up on live hogs and the consumption of pork products was materially reduced, because there was so much agitation about the processing tax and high prices. It all had a psychological effect.

I am satisfied that many people turned to other foods. They went to fish and other things. I even heard on the radio one time a man who was advocating using other things than meat. So we had all of those things to contend with.

In addition to the reduction of the buying power of the public, one of the outstanding elements was this, that during this period, this pressure became greater and greater upon every small concern in the country. The result was that we were pressed for working capital.

Well, what was the result? As all of you gentlemen know, live-stock has to be paid for in cash the day you buy it. There are no credit terms. Men had to go out, and they bought cattle, and they had to pay cash for it. Then they were pressed for funds to keep their operation going and they sold their products, not only their fresh products but their provisions, to obtain funds to turn over their business quickly.

The result was that it weakened the whole price structure right along through this period of the processing tax. And that, in turn, reduced prices further, so that you could not sit and hold and say, "Well, we will wait for a better price." It could not be done.

Then, another thing that we had to contend with was this: You might say, "Well, you ought to have forced these prices up, even through these weeks." We were confronted with farmers' competition, killing hogs on the farm and peddling them out to the stores, particularly in the small cities, and in many cases bootlegging them, which is proven by the records of the Treasury agents, checking them up here and there.

Now, just another angle on this: Over a period of 75 weeks we paid a total to the Government of \$207,701.04. That would equal \$1,661 plus, for every employee that we had on the pay roll.

That does not include the matter that they are talking about, about this money that was impounded and afterward returned to us. That is a terrific burden for any small business to stand, \$1,661 tax piled on every man in the organization. I tell you, gentlemen, that is pretty heavy.

Now, there is another thing. I cannot speak of this as a fact, but I believe it is a true statement. That is this, that if we had a breakdown of the large packers, a profit and loss statement, we would find that in 90 percent of the cases, through the United States, their hog operations showed a loss, and it was simply overcome by their large activities in other lines. Then let them show this before-mentioned profit that I spoke of. I believe those are the facts.

Mr. COOPER. You have consumed the time requested.

Mr. WELSHNER. May I have just a moment or two more? I will be very brief. There is one question here that I think is important.

Mr. CROWTHER. I ask unanimous consent that the gentleman's time be extended 5 minutes.

Mr. COOPER. The gentleman asked for only 2 minutes. Without objection, the time of the gentleman is extended for 2 minutes.

Mr. WELSHNER. I will be brief.

Now, the question of the disposition of this refund comes up. We felt that the money was taken away from us illegally, and we got it back. We had no hesitancy in spending that money, because we felt that it was ours. We reduced our indebtedness and got back to our old standard of discounting our bills, and we felt that would give us a little more working capital. Now it is in trade channels.

I will admit that what we got back is practically nonexistent now because it is out in the form of cattle, and we would be mighty hard pressed to dig it up at this time.

The effect of the tax collection would further reduce the working capital and place business under a severe strain. We will probably have to reduce our small operations very materially, and lay off some of our men who have been in our employ for a long time.

We doubt, if we were compelled to pay that money back, that the bank would say we will give you capital to operate with. And we have got to have some money to operate. I do not believe you could interest new capital in a business taxed out of existence, because they would hesitate very much to go into a thing of that kind.

Some of our friends say maybe we ought to pay it because some of the packers did not pay it. That was not our fault. Some say that it was unfair in not putting them on a basis where they had to pay. It was unfair to us that we had to pay and some others did not.

If this additional burden is put on, we are going to be in bad shape.

If you say you will collect this so-called windfall tax, on the other side you have this picture: You will have an enormous cost for collecting this tax, and there probably will be a lot of lawsuits running a good many years. Of course, I understand that is not a particular objection from the standpoint of the Government.

It will throw employees out of work, and the chances are that a great many thousands of these men will be thrown on relief. That would mean that it would probably be 25 or 30 million dollars that that might run into. That would be a big hole in the windfall tax right there.

Another thing, when you destroy the small concerns throughout the country, you will also destroy the small livestock markets, because the farmers cannot go to the primary markets and sell their stuff.

The members of the committee here from Ohio will recall such markets as those at Washington Court House, Chillicothe, Wilmington, Piqua, and other points. The farmers who go in there with three or four hogs in a truck cannot go to the large primary markets to sell their stuff, and you will wipe those people out of business.

Mr. LAMNECK. How much was due the Government by you when the A. A. A. was declared unconstitutional?

Mr. WELSHNER. We had impounded at that time \$62,833.22.

Mr. LAMNECK. What were your profits in 1933, 1934, and 1935?

Mr. WELSHNER. I am sorry to tell you we had no profits in any one of those years.

Mr. LAMNECK. How much tax did you pay in those years?

Mr. WELSHNER. The processing tax we actually have in the hands of the Government now is \$207,701.12.

Mr. LAMNECK. How many men do you employ?

Mr. WELHENER. One hundred and twenty-five men.

Mr. LAMNECK. You say that if the Government would levy this tax as proposed in this bill of 90 percent against the processing tax due the Government it would be a great hardship on your company?

Mr. WELHENER. Yes, sir; I just do not know what we would do. We are worrying about it.

Mr. LAMNECK. As a businessman, would you say you were not able to pass the tax on to your customers?

Mr. WELHENER. Yes, sir.

Mr. LAMNECK. During the whole period?

Mr. WELHENER. Yes, sir; that is the period from the time it started on November 5, 1933.

Mr. LAMNECK. Is your concern in good financial condition now?

Mr. WELHENER. I would not say we are so good. Our last statement shows a deficit, changing from a surplus into a deficit of \$124,000. For our last year in 1935 we show a loss in our working capital of over \$47,000.

Mr. LAMNECK. Do you think your condition truly reflects the condition in the packing industry?

Mr. WELHENER. I do, because I talked to a number of different people in our own neighborhood and some at quite some distance when I have had the opportunity, and they all had the same impression; they do not know how they will weather the storm.

Mr. THOMPSON. At the beginning of your statement you said your concern, over the years, had built up a large goodwill that you did not want to lose.

What is there in this proposed legislation that will break down that goodwill? What did you mean by that?

Mr. WELHENER. I mean if you put us out of business all our efforts during the years are for naught.

Mr. THOMPSON. Were you a party to any of the litigation testing the constitutionality of the A. A. A. Act?

Mr. WELHENER. On the processing tax?

Mr. THOMPSON. Everything.

Mr. WELHENER. Yes, sir. Along in last summer, when we saw that we were getting in a bad way in this matter, our lawyers advised us that this tax was unconstitutional. We sought to get an injunction to prevent the collector of internal revenue from collecting this money, and the result was that we put it on deposit in a joint account for the collector and ourselves, and we did that as the result of a decision of the court. We put this amount of \$62,000 in a joint account.

Mr. THOMPSON. You understand, of course, that if your company absorbed this processing tax this bill does not apply.

Mr. WELHENER. I think I understand that if you can prove that you did not absorb this tax.

As I said before, you cannot send several Government accountants in there and have them say, let us see where you charged it, or did not charge it on these pork returns. But I can say that on a hundred percent of our pork business we did not get it.

Mr. THOMPSON. You kill other animals than hogs?

Mr. WELHENER. Yes; we kill hogs, cattle, and sheep.

Mr. THOMPSON. There was a rise in the price of general meat products, that is, the price went up during the period of the opera-

tion of the A. A. A. There was no processing tax applied then on kindred meats, veal, lamb, and so forth.

Do you not think a rise in price on pork was very advantageous to your business and to the business of your competitors, on account of a sympathetic rise of other meat products, which enabled you to make a profit?

Mr. WELHENER. I am sorry to say I cannot agree with that theory, for this reason. All during that period we were paying more for hogs and we had to meet the market conditions. But still the normal demand was wiped out.

Mr. THOMPSON. That was the policy of Congress in enacting the A. A. A. to build up and increase farm prices to a parity with the prices during the period from 1909 to 1913.

Mr. WELHENER. With the fresh products we have to move, we have to move them on a current market.

Mr. VINSON. How do you make your income-tax return, by the fiscal year or the calendar year?

Mr. WELHENER. By the fiscal year.

Mr. VINSON. What is your fiscal year?

Mr. WELHENER. It is always customary to have it end at what is called the end of the taxing year, about the 1st of November.

Mr. VINSON. You have a definite date for that, do you not?

Mr. WELHENER. I should say about November 4.

Mr. VINSON. The taxes involved in the moneys that were impounded were taxes for what period?

Mr. WELHENER. They were taxes for the period from the beginning of May to about the 1st of October.

Mr. VINSON. That is from May to October 1935?

Mr. WELHENER. Yes, sir.

Mr. VINSON. For the fiscal year ending November 1, 1935—and that is your income year?

Mr. WELHENER. Yes, sir.

Mr. VINSON. Did your concern report any net income?

Mr. WELHENER. No; we were in the red; we could not.

Mr. VINSON. As I understood it, for 2 or 3 years prior thereto you were in the red?

Mr. WELHENER. Yes, sir.

Mr. VINSON. You contend that you did not pass the processing tax on?

Mr. WELHENER. Yes, sir.

Mr. VINSON. What you really think of and fear is that you may not be able to show that to the satisfaction of the collector?

Mr. WELHENER. No; our fear does not lie there.

Mr. VINSON. If you have not any fear of that, what can you be afraid of?

Mr. WELHENER. Because of the way that rumors come to us in places of that kind is that they are going to put this tax on and take it away from us regardless, just because we got it back from the Government.

Mr. VINSON. Mr. Welhener, I am glad to get your viewpoint on that, and in order to give you the attitude of the subcommittee, I would like to give you a copy of the report the subcommittee made to the full committee, so that you can see that those rumors certainly are unfounded.

If expressed in a law, the report of the subcommittee would not reach the case of a processor where they had not passed the tax on.

It is our philosophy and theory under the windfall tax to levy a tax upon that portion of a taxpayer's income whereby he had been enriched because of his collection of the processing tax from someone else.

Certainly it will not be the purpose of this committee, and I feel certain not of Congress, to inflict or impose that tax upon a person who has absorbed it.

Mr. WELHENER. That makes us feel easier.

Mr. VINSON. We are very happy to be able to relieve your mind.

The CHAIRMAN. You say you had losses in your business in what years?

Mr. WELHENER. It started about 1930, because we were in a period of declining inventories. It would seem that we bought the stock and by the time it was ready for market there was a loss of inventory.

The CHAIRMAN. In the years when you had those losses in inventory, were you paying a processing tax?

Mr. WELHENER. Of course, we did not start paying the processing tax until November 5, 1933.

The CHAIRMAN. Did you have losses prior to the time of your losses in inventory?

Mr. WELHENER. Yes, sir.

The CHAIRMAN. When this impounded tax is refunded to you, will that still leave you in the red, or bring you out on the other side of the ledger?

Mr. WELHENER. It will bring us out pretty close. We have not separated our operations on the books. We can strike it pretty closely on our record sheets on beef, cattle, and sheep.

The CHAIRMAN. It will be helpful, at any rate?

Mr. WELHENER. Yes, sir; it will be helpful.

Mr. REED. You were asked by one of the members of the committee if you were a party to the litigation that resulted in the action of the court declaring the three A's unconstitutional. I believe you said—

Mr. WELHENER. I get your point. I do not know that we went that far. Of course, we got into litigation and tried to get out an injunction against the collector.

Mr. REED. You had a perfect right to do that, did you not, as a citizen of the United States?

Mr. WELHENER. We think so.

Mr. REED. The Supreme Court is there for that very purpose, to prevent encroachment upon the rights either of individuals or corporations.

Mr. WELHENER. Yes, sir.

Mr. REED. So there is no stigma attached to the fact that you resorted to the courts to protect your rights?

Mr. WELHENER. No.

Mr. VINSON. And nobody suggested that.

Mr. REED. But the way the question was asked, I did not see that it had any particular bearing on the case as to whether he was a party to the transaction or not.

Mr. VINSON. It is easy for the gentleman to set up a straw man, but I do not see why he should do it.

Mr. REED. One thing that happened was the creation of sales resistance from your customers, was it not?

Mr. WELHENER. Decidedly.

Mr. REED. They shifted to other products, and that is one of your reasons for your loss. You say accountants could not determine whether or not you had shifted the tax on to the consumers. That is your view of that?

Mr. WELHENER. The point I was making was that an accountant could not determine on an individual item, but he can take the total of our sales and the total of our pork operations and be convinced that it was not passed on, because if it had been passed on it is obvious to everybody that that would have been something we could have done without making a profit.

Mr. REED. Of course, this committee is doing this by raising a presumption against you, according to the report, that you passed it on.

Mr. WELHENER. Yes.

Mr. REED. So you have to meet that presumption.

Mr. WELHENER. Yes; and that is why we took the liberty in coming down here.

Mr. LAMNECK. You say you paid, altogether, \$250,000, or that is the total amount of the tax assessed during this period, and you paid \$145,000?

Mr. WELHENER. I might explain that in this way, that the total amount assessed was close to \$270,000, of which we took a little over \$62,000, which represented about 25 percent of the total amount imposed.

Mr. LAMNECK. You actually paid to the Government \$262,000.

Mr. WELHENER. At that time, but—

Mr. LAMNECK. You say you did not pass any of that on to the consumers?

Mr. WELHENER. No.

Mr. LAMNECK. Therefore, if you are allowed to retain this \$62,000, you will still be out \$200,000 that the Government has taken away from you, that you could not pass on?

Mr. WELHENER. We feel that way.

Mr. LAMNECK. That is correct?

Mr. WELHENER. Yes, sir.

The CHAIRMAN. Is it a fact that you were not able to get any more for your processed goods after you had paid the tax than you would have been able to get for them if you had not paid any tax? The price of your goods was not increased on account of the tax at all?

Mr. WELHENER. No, I do not think it was. Our selling is controlled entirely by market conditions.

The CHAIRMAN. I am not talking about control. I am asking you if you were able to get any more for your products after you had paid the tax than you would if the tax had not been put on. Did you increase the price?

Mr. WELHENER. I do not think so.

The CHAIRMAN. The next witness is Mr. F. E. Wernke, of Louisville, Ky.

Will you give your name to the stenographer and state the capacity in which you appear?

STATEMENT OF F. E. WERNKE, LOUISVILLE, KY., PRESIDENT OF THE LOUISVILLE PROVISION CO.

Mr. WERNKE. Mr. Chairman, my name is F. E. Wernke. I am president of the Louisville Provision Co., a corporation of Kentucky with its principal office and plant located in Louisville, Ky. In 1910 this company was organized and started business as pork and beef packers and continued operations until 1931, at which time it filed a petition in bankruptcy in the district court of the western district of Kentucky. Operations were continued under protection of the court until November 1932 when several of the older employees and myself purchased the assets of the old company out of the bankruptcy court and with some additional capital represented by the savings of ourselves, reorganized and started business with an outstanding paid-up capital of \$50,000.

From 1932 until date several additions have been made to the capital of the company by the selling of additional common stock and the flowing of a small amount of preferred stock until at present the outstanding paid-in capital amounts to \$80,000. The company is engaged in the slaughtering of cattle, sheep, and hogs and the curing and selling of the products thereof. The company employs normally approximately 215 people, with an annual pay roll of about \$250,000. The volume of its purchases of hogs averages, in value, approximately \$1,250,000 annually.

In November 1933 the so-called processing taxes under the Agricultural Adjustment Act went into effect. The original tax, effective November 5, 1933, was 50 cents per hundredweight live weight. On December 1, 1933, the tax was increased to \$1 per hundredweight, and on February 1, 1934, increased to \$1.50 per hundredweight, and the final rate, effective March 1, 1934, was established at \$2.25 per hundredweight live weight. From March 1, 1934, to January 6, 1936, the rate remained unchanged at \$2.25.

The company paid its processing taxes as they accrued until it had paid up to the 1st of January 1935 a total of about \$235,000. In March 1935 it found it financially impossible to continue the payment of these enormous taxes. These taxes represented an outlay of between \$20,000 and \$25,000 a month, an amount which was a drain upon its working capital. The company pays cash for the hogs it buys and has to carry the product 60 to 90 days before they can be sold. The company is capitalized upon this basis. With the addition of approximately \$20,000 to \$25,000 per month of processing taxes on its cost of operation, its working capital was not sufficient and it had to dip into its capital for the payment of these taxes.

This situation—resulting, first, from the imposition of this large tax upon its business; and, second, from the reduction of the available supply of hogs caused by the production-control program of the Secretary of Agriculture, together with the drought—was, of course, financially destructive to the company, and in March 1935 it felt compelled to file a bill of complaint in the district court for the western district of Kentucky to restrain the further collection of the taxes.

In the early part of June a temporary restraining order was entered but the financial condition of the company was such, as the result of the payment of the processing taxes, that it was unable to deposit security for the payment of the tax, if held constitutional, and in lieu thereof the court required that a bond for \$10,000 be filed. After the decision of the United States Supreme Court in the *Housan Mills* case on January 6, 1936, and in the *Rice Millers* case on January 13, 1936, the bond was ordered discharged.

Due to its inability to make a cash deposit covering taxes accrued to June 1935, the Louisville Provision Co., under its temporary injunction entered in the early part of that month, was not required to deposit with the clerk of the court amounts equivalent to taxes accruing each month until November 1935, when the company then owed upon an accrued basis approximately \$80,000 of taxes. On November 1, 1935, Federal Judge Ford required the company to deposit with the clerk of the court amounts equivalent to the taxes accruing each month beginning with the month of September 1935. The aggregate of these deposits for the months of September and October 1935 was approximately \$18,000. In order to make these payments the company had to restrict its operations and liquidate a large part of its inventory and some of its accounts receivable. After the decision holding the Agricultural Adjustment Act unconstitutional this amount was refunded to the Louisville Provision Co.

During the period from November 5, 1933, at which time the processing tax on hogs went into effect, and continuing on through to the present date, the production-control program put into effect by the Secretary of Agriculture together with the drought so decreased the number of hogs available for slaughter that the business of this company in hog products was curtailed by two-thirds of its normal slaughter. This is evidenced by the amount of taxes accrued during the latter months of 1933, which decreased from \$30,000 a month to \$8,000 a month, and by the decrease of slaughter from the normal operating kill of 1,500 hogs per week to between 500 and 600 hogs per week. One of the most serious effects upon the business of the company and one which cannot be estimated is the fact that the increased cost of pork products, due to the processing taxes and the decreased production of hogs, has caused the laboring classes, who are the principal consumers of pork, to switch from pork to fish, poultry, and other competing foods.

The payment of the processing taxes, together with the decrease in the volume of hogs available as the result of action of the Department of Agriculture and the drought, was destroying the capital structure of the company. The decision of the United States Supreme Court holding the Agricultural Adjustment Act unconstitutional, thus freeing the company from the payment of these taxes, and refunding to the company the small cash amount that had been impounded, saved the company's financial life and, in turn, the jobs of 215 employees, a portion of whom otherwise would have had to go on relief.

If now Congress enacts a law requiring processors to pay into the Federal Treasury these unconstitutional taxes, or taxes equivalent thereto, the company will be in the same position that it was in at the time the law was held unconstitutional. It will be destroyed and its employees will be deprived of their jobs and obliged to seek em-

ployment elsewhere or go on public relief, and the farmers from whom it has been buying hogs will have lost a competitive outlet for the accustomed and convenient disposition of their hogs. The company annually expends for the purchase of hogs, supplies, pay rolls, repairs, construction, operating and other expenses approximately the sum of \$2,000,000. With the destruction of the company the circulation of this sum would necessarily be discontinued or materially decreased.

This company's case is not an isolated one. All processors of hogs have lost large sums of money upon their pork-packing business. Many, and this is especially true of processors engaged in only pork packing, have escaped financial destruction because the Agricultural Adjustment Act was held unconstitutional. The enactment of the so-called "windfall tax" equivalent to the amount of money which would have been collected from processors if the Agricultural Adjustment Act had been held constitutional will destroy a large number of small pork packers throughout the country. Such a tax will fall most heavily upon the small packer least able to bear it.

Mr. VINSON. Mr. Wernke, have you read recommendation 24 of the subcommittee report?

Mr. WERNKE. I do not believe I have, Mr. Vinson.

Mr. VINSON. I would like for the clerk of the committee to give you a copy of that report, and then you can make any comment you desire, as an addendum to your remarks, after you have given consideration to it.

Mr. WERNKE. I will be glad to do so.

Mr. VINSON. It is the purpose stated in that report to impose this so-called "windfall tax" upon that part of the net income of the taxpayer that accrued to him solely from his having passed the tax on.

Did your concern absorb the tax, or did you pass the tax on and collect it from the person to whom you sold your processed goods?

Mr. WERNKE. Our hog operations, during the months of operation on the hog farm showed a loss per month, and a shorter loss at the end of our fiscal year, which is October 31 of each year.

Mr. VINSON. Did it show a loss, with the tax considered?

Mr. WERNKE. It showed a loss by taking into consideration the amount of taxes accrued and that were not paid, and also the amount of those that had been paid, which amounted to about \$235,000.

The CHAIRMAN. Did your company have any period in which you lost money, prior to the time of the imposition of the processing tax?

Mr. WERNKE. The company that I represent now, Mr. Doughton, was organized in November 1932. The Louisville Provision Co. has been in business really for about 25 years, but as I stated in my opening remarks, in April 1931 this company had some severe losses, and in prior years, and found itself unable to pay its debts, and had to go into bankruptcy.

The CHAIRMAN. Was that caused by the processing tax?

Mr. WERNKE. I think that was due to mismanagement.

The CHAIRMAN. And then it was reorganized?

Mr. WERNKE. In November 1932. Some of the older employees of the company and myself—I happened to have been an employee of the company since 1922—purchased these assets out of the bankruptcy

court, and through the savings we had accumulated over the period of years, we started anew this company.

The CHAIRMAN. You had hardly been in business with the new company long enough to tell what your experience would have been if the present tax had been imposed. Were you making or losing money at the time the processing tax was imposed?

Mr. WERNKE. At that time we were making money.

Mr. CROWTHER. Section 24, about which Mr. Vincent spoke to you, says:

The taxpayer would be presumed to have shifted the burden of the tax to the extent that his gross-profit margin with respect to the articles in question—

That would be the pork products, of course, would it not?

Mr. WERNKE. Yes, sir.

Mr. CROWTHER (continuing):

exceeded his gross-profit margin during the representative period preceding the tax.

As I remember, there was some discussion about what that representative period should be. I think somebody, either some of our members or someone from the Bureau of Internal Revenue, said 2 years, as I understood it. In your endeavoring to make a showing before the Commissioner of Internal Revenue, that would involve the segregation on every invoice and on your books of every pork product that was sold, would it not?

Mr. WERNKE. That is true.

Mr. CROWTHER. It would be a very difficult thing to go through an invoice and pick out sausage, ham roll, and all these things that might contain some beef, veal, lamb, and a lot of other things?

Mr. WERNKE. Does this state your gross profit?

Mr. CROWTHER. A little further down in that section this language seems to modify somewhat that presumption:

The above rules for determining the extent to which the tax burden was shifted should, of course, merely establish a presumption.

Then it goes on to say further:

Either the taxpayer or the Commissioner should be allowed to show that other factors than the tax accounted for the change or lack of change in the taxpayer's gross profit margin.

It has been stated here by some of the gentlemen who were here this morning that a number of them perhaps made a little more money on their byproducts and various other operations to offset their loss in pork. I remember the question was asked, "Why, you are not going to try to collect this tax from a concern that has lost money, are you?" And the answer of the Bureau of Internal Revenue was, "Yes." Somebody said, "If they lost \$80,000, maybe they would have lost \$150,000 had it not been for the tax, so we will collect it just the same from the fellow that had a bad showing."

If I am wrong about that I want somebody to correct me, but that was the impression that I got, that we were going right after it, even after the fellow that had lost money, because he would have lost a little more money, they argued, if it had not been that he had received the tax or that he had held it.

The CHAIRMAN. Why should he receive reimbursement when it was the consumer who paid it?

Mr. CROWTHER. As I remember it, you offer the suggestion that you would be mighty glad to have the consumer get it back, but you know the consumer cannot get it back. There is no possible way he can get it back. You brought that point out yourself, that if they finally got it back, if anybody ought to collect it ought to be the consumer, but of course, it is an impossibility that the ultimate consumer can get it back after having paid it on every pound of sausage, slice of ham, yard of bacon, and everything else. The consumer just would not get it.

Mr. LAMNECK. This 2-year period on the basis of which they are going to figure out what profits or losses we had covers the 2 years where they lost the greatest amount of money as the result of the processing taxes, 1933 and 1934.

Mr. CROWTHER. That is it exactly.

Mr. LAMNECK. So it would not be a very good comparison, would it?

Mr. CROWTHER. It does not look as though that would be a very good yardstick by which to measure it.

Mr. WEINKE. Mr. Chairman, may I make one further statement? The CHAIRMAN. Certainly.

Mr. WEINKE. I have checked into the prices of fresh pork commodities for the years 1930 and 1931, at which time hogs were selling at about \$8 per hundred live weight. The wholesale prices of pork loins, green hams, green shoulders, Boston butts, and other various commodities coming from the hog, showed that we were getting from 3 to 5 cents per pound more during that period for those same commodities than we were during the period of 1934 and 1935, when hogs were still \$8 per hundred live weight, but on top of that we were asked to pay a tax of \$2.25.

Mr. CROWTHER. I think that is the answer, Mr. Chairman.

The CHAIRMAN. There was nothing said in the report about the 2-year period; it was the average.

Mr. CROWTHER. I said it was discussed inferentially and informally that that period would be 2 years. We did not identify it any more than we identified rates. We left some glittering generalities but no real factual observations.

Mr. TREADWAY. Let me see if I understand the pith of your statement, namely, that up to March 1935 you had paid in processing taxes \$235,000.

Mr. WEINKE. That is correct.

Mr. TREADWAY. Which had impaired your capital?

Mr. WEINKE. That is correct.

Mr. TREADWAY. From March 1935, or about that time, you found it necessary either to seek financial assistance or else go into the hands of the receiver, was that it?

Mr. WEINKE. In March 1935 we found it financially impossible to make these payments, so we filed an injunction suit and secured relief in that way. That was temporary relief.

The TREADWAY. That relieved you temporarily?

Mr. WEINKE. Yes, sir.

Mr. TREADWAY. Then I understood you to say that when the Supreme Court decision was rendered declaring it unconstitutional,

that gave you an opportunity to proceed with your business once more and have a little capital to work with?

Mr. WEINKE. Yes, sir.

Mr. TREADWAY. But you now find that an effort is being made to secure the same sort of a tax, but by a different name, not now known as a processing tax, but in the future to be known as a windfall tax. If that windfall tax is put into operation, you feel very confident that your company will be on the rocks exactly as it was in March 1935?

Mr. WEINKE. Yes, sir; it will. We will absolutely be unable to pay it. We would have to liquidate.

Mr. TREADWAY. Your 200 employees would have to get other employment?

Mr. WEINKE. They certainly would. We would have to cut down to the place where it would be impossible to make any money on account of our overhead expenses, and we would have to go out of business.

Mr. TREADWAY. I also understood you to say that your case was not an isolated one.

Mr. WEINKE. No; it is not an isolated one.

Mr. TREADWAY. Your case is practically typical of others all over the country in your line of business, trying to make a go of it in a modest way?

Mr. WEINKE. I would estimate that 70 percent of the small packers, such as we consider ourselves to be, would have to go into bankruptcy and receivership and reorganize, or else go out of business entirely.

Mr. TREADWAY. You stand on that statement in view of your practical business experience?

Mr. WEINKE. Yes, sir; and in view of what I know of the financial condition of numerous other packers besides myself.

The CHAIRMAN. You do not understand, as suggested by my colleague and friend, that this tax proposed in this report is for the same purpose for which the processing tax was imposed, or is the same kind of a tax?

Mr. TREADWAY. It is the same general purpose.

The CHAIRMAN. Not by any means at all, if I know anything about it. This tax is for the purpose of recovering some money by which some processors may have been improperly enriched on account of a previous tax.

Mr. WEINKE. That is what we were afraid of.

The CHAIRMAN. The previous tax went directly to the benefit of the farmer. There is no analogy between the two at all, so far as the purpose is concerned.

Mr. WEINKE. Mr. Chairman, we are afraid that the rules and regulations laid down by the Congress in figuring us to whether or not a corporation had been unduly enriched by these taxes will not be specific and clear enough.

The CHAIRMAN. I am not trying to interpret that; that is for the future. It is our purpose that it should be so construed and so determined. But the point I made is that the two are not similar taxes nor are they for similar purposes.

Mr. VINSOS. Mr. Chairman, I think that the gentleman ought not to have too much fear until he gets the viewpoint of the sub-

committee itself. If I understood you correctly, you said you had not read that part of the report which deals with the "windfall" taxes.

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

Mr. VINSON. Of course, we can be afraid that we are going to get run over by an automobile, and we may get run over by an automobile, but if we go out there and read the signs on the streets and watch the lights, we may, with the help of a beneficent policeman, get across that street without hurt, and the fear that we have had would be dissipated in thin air.

I would like to make this statement to the gentleman, that my understanding in connection with this windfall tax is that the purpose is to levy a tax upon that part of a person's income which is augmented by this tax, and if you do not have any income with the tax, then it seems to me that you would be in a position of having a zero base, and thereby no windfall tax.

Mr. WERNKE. Mr. Vinson, suppose a company shows, as an example, that they lost, we will say, \$50,000 in actual money upon their pork operations during a 1-year period, ending at, say, the 1st of January. The taxes that they accrued and set up on their books would be \$75,000. Now, since the Supreme Court has invalidated the A. A. A. taxes, naturally that accrual disappears from its statement, and that \$75,000 goes back into operations. Would the Internal Revenue Bureau say that they had actually made a \$25,000 profit?

Mr. VINSON. What do you think about it?

Mr. WERNKE. That is what I would like to know.

Mr. VINSON. What do you think about it as a fair businessman?

Mr. WERNKE. I would say that the \$25,000 profit was a normal profit for the amount of business, and the company should not be taxed any "windfall" tax at all, because they certainly should be able to make a profit upon the business that they do, and not sustain a loss.

Mr. VINSON. If you had not had this tax—

Mr. WERNKE. If we had not had that tax we might have made a profit.

Mr. VINSON. I am not going to say this in respect of you, but these pork packers, if they have that notion, might be what we would call in eastern Kentucky a little "boggish."

Take your illustration: Because of this tax you have had a net income over your loss in your pork operations of \$25,000. You would not have had that except for collecting that tax from somebody to whom you sold the goods. But let us take this illustration: Say you had a \$50,000 loss in your pork operations and your tax was \$49,000. Then, by the same reasoning you would have no net income in your pork operations, even though you consider the tax in relation to your pork operations.

Mr. WERNKE. That is right.

Mr. VINSON. Your tax base for your pork operations, even with your processing tax, is zero.

Mr. WERNKE. That is right.

Mr. VINSON. Then your "windfall" tax rate applied to your zero base would be no tax?

Mr. WERNKE. Would your "windfall" tax rate be applied if, on my theory, you lost \$50,000 and your taxes are \$75,000? Then is the Congress' idea that the \$25,000 which would be a profit to the corporation would be taxed as a windfall tax?

Mr. VINSON. I could not say what Congress' idea would be, but that is my idea. But I will also say, without saying what Congress' idea is, what my idea is: That if your tax is \$49,000 and your loss is \$50,000 in your pork operations, then there would be no "windfall" tax at all. If that is not giving you a break, I do not know what would be a break; and I think it is fair, because you have no net income, even with the use of your processing taxes, in your pork operations. That is my thought—I am speaking now personally—that you have to have a net income even with the use of the tax in augmenting your pork operation base before this "windfall" tax rate could apply. That is my own personal view.

Mr. REED. Mr. Vinson probably is better at formulating questions and leading a witness than any man you have ever confronted, and he is leading you to believe that the purpose of this bill is not to tax; but, of course, under this "windfall" tax provision they expect to get \$100,000,000, and you are presumed guilty until you are proved innocent. I just wanted to remind you of that when you read that.

Mr. VINSON. I want to say to my friend from New York that when he says I was leading the witness to believe that he was not paying any taxes, my friend from New York evidently was out of the room at the time I spoke of that, or he was not giving his usual close attention, because I stated, according to my recollection of the illustration that he gave, there would be a tax upon \$25,000, and under the illustration that I gave, where the tax did not bring the business operation to a net income, there would be no tax. I do not know but what the gentleman from the Louisville Provision Co. would be satisfied with that interpretation of it.

Mr. WERNKE. I think that any businessman certainly is entitled to a profit upon the business that he does. If he goes so far as to risk his own funds and the funds of his investors to a loss, he certainly is entitled to a profit.

Mr. VINSON. I would hope that our minds are meeting on this point in regard to your \$25,000 net income, which I think would be subject to tax. Of course, that is on the assumption that you have passed that tax on. If you have absorbed it, then, of course, it does not make any difference what the situation would be, for if you have absorbed the tax and have not passed it on, then, of course, you have no base.

Mr. WERNKE. I do not believe there is anyone in the United States who could say whether a pork packer passed his tax on or paid it. The books are kept in such a way that I do not think you could say that. You paid the tax on the live hog, you did not pay the tax on a product. You took that hog and cut him up into 125 different pieces. I do not believe it is physically possible to say that.

Mr. VINSON. I do not think that the gentleman will undertake to say that business should be guaranteed a profit.

Mr. WERNKE. No. I wish we would.

Mr. VINSON. Or that there should not be a tax where a profit was made by the collection of a tax from those to whom you sell the

article and it was retained by the business and not paid to that Government for which the tax was collected. And I just do not believe the gentleman will say that our treatment of it when it comes out will be unjust or unfair.

Mr. TREADWAY. If you are persuaded by the eloquent type of pleading that you have just heard that you are not likely to be called upon to pay any "windfall" tax, have you not a good deal of sympathy for those from whom they estimate they are going to get \$100,000,000?

Mr. WERNKE. I certainly have.

Mr. TREADWAY. Yes. I thought you would at least have sympathy.

The CHAIRMAN. The gentleman said that he did not believe anyone could tell, when the hog was cut up into so many different parts and distributed, whether in any particular transaction the packer was getting paid for his tax or not.

Mr. WERNKE. That is right.

The CHAIRMAN. I am going to give the gentleman credit for being a more intelligent man than that. Your appearance before this committee has demonstrated to me that you are a man of enough business acumen, judgment, and experience to know when you buy a hog, with a processing tax of \$2 or \$2.50 per hundred, and then sell the meat, whether or not you have increased the price of the product on account of that tax. You might not know exactly to a fraction of a cent, but you know whether or not you have increased the price of that product. You certainly know that.

Mr. WERNKE. Mr. Chairman, you can only get for your product what the consumer will pay.

The CHAIRMAN. That is not answering my question, and that is not meeting my statement. I said, you know whether or not you have increased your price on account of that tax.

Mr. WERNKE. It is very hard to say.

The CHAIRMAN. There is a difference of 2 or 2½ cents a pound.

Mr. WERNKE. That is 2½ cents a pound, remember, Mr. Chairman, on the live weight.

The CHAIRMAN. I understand that.

Mr. WERNKE. Not on the dressed product.

The CHAIRMAN. You would have to put more on the other in order not to have a loss.

Mr. WERNKE. That is hard to do, because those products are sold for anywhere from 3 to 40 cents a pound.

The CHAIRMAN. In other words, do you state to the committee that you went ahead with your business transactions, paid this tax, and sold your commodity just as though you paid no tax?

Mr. WERNKE. We have to—

The CHAIRMAN. Did you do that or not?

Mr. WERNKE. Of course, we figured that it was a liability.

The CHAIRMAN. Did you figure that was just as much a liability as the cost of that hog?

Mr. WERNKE. Yes, sir.

Mr. COOPER. Mr. Wernke, you buy hogs by the cent or even the fraction of a cent, in figuring prices, do you not?

Mr. WERNKE. Yes, sir.

Mr. COOPER. You certainly should know within 2½ cents how you were bidding and buying your hogs.

Mr. WERNKE. How we were buying our hogs?

Mr. COOPER. Yes.

Mr. WERNKE. You buy the hogs upon the open market. We do not make the hog market.

Mr. COOPER. I understand, but you know within that margin how you are buying your hogs, do you not?

Mr. WERNKE. No; I do not think we do.

Mr. COOPER. You just do not have any idea about how you buy them, about how you expect to come out?

Mr. WERNKE. Oh, yes; certainly we have an idea about how we expect to come out there. We figure that every day. We know that during the period the tax was on we lost money on every hog we killed.

Mr. COOPER. Get away from that for a moment, if you please, sir; would you say when you buy hogs and process them you cannot tell within 2½ cents a pound how you are going to come out?

Mr. WERNKE. We can on the whole hog.

Mr. COOPER. That is what I am talking about.

Mr. WERNKE. But we do not sell the whole hog.

Mr. COOPER. You sell all that is salable of him, do you not?

Mr. WERNKE. Yes. He is cut up into various parts.

Mr. COOPER. But you do not think, then, that you could tell within 2½ cents a pound on a hog how you are going to come out on him?

Mr. WERNKE. You cannot tell what portion of that tax is allocated to those various products.

Mr. COOPER. So it does not make a bit of difference to your business whether you pay the farmer 10 cents a pound or 15 cents a pound, does it?

Mr. WERNKE. Oh, yes; it does.

Mr. COOPER. Two and five-tenths cents difference would not amount to anything?

Mr. WERNKE. It amounts to a whole lot on a hog when you figure the dressed percentage.

Mr. COOPER. Then, how do you justify the statement that you could not tell whether that 2.25 would have any effect on it or not?

Mr. WERNKE. Oh, yes; we can tell whether the 2.25 cents had an effect on it. I said we could not tell what portion of that 2.25 cents was allocated to the various cuts.

Mr. COOPER. Nobody is expecting you to allocate the 2.5 cents in the proper proportion to the loin and the ham and the shoulder and the feet and the various pork products which you get out of a hog, but certainly in your business operation you can tell how you would come out on your combined operation as reflected by the price you have to pay for the stuff.

Mr. WERNKE. Oh, yes.

Mr. COOPER. There is no doubt about that. As stated here before, you understand the proposal here to be that if a man did not pass this tax on to his customers he is not affected by the windfall tax at all. You understand that?

Mr. WERNKE. That is right; yes.

Mr. COOPER. If a man did pass the tax on and collected from his customers, and he then failed to pay it to the Government, do you think he ought to keep that money?

Mr. WERNKE. No; I do not think he should.

Mr. COOPER. All right; thank you.

Mr. CROWTHER. I want to say to the witness that he should not forget that the showing has to be made, according to this language here—of course, the law is not written yet—before the Commissioner of Internal Revenue, as to whether or not he passed the tax on. I think you are the third witness that we have had that has said that that would be a very difficult thing to do.

Mr. WERNKE. Yes.

Mr. CROWTHER. I think you are the third witness engaged in this industry who has made that statement.

Mr. WERNKE. It would.

Mr. CROWTHER. And do not forget that, when you go before the Commissioner of Internal Revenue to try to make your showing, even although you had a loss—and you are the third witness, I think, who has stated that they had a loss on their pork products during this period tax—if there is a shadow of a doubt in the mind of the Commissioner of Internal Revenue that you did pass it on, he is going to collect it from you just the same.

Mr. VINSON. If that loss is shown on the processing operation after you consider the tax in income, in my opinion there will not be any tax paid.

At this point the Commissioner of Internal Revenue hands me the subcommittee report wherein certain language is used which may be of benefit to the taxpayers. I read from page 8, under paragraph 24, "Windfall tax":

This tax would be a special income tax. In the first class, the tax would be computed as follows: The net income from the sale of the articles with respect to which the tax was supposedly imposed but not paid (or was paid and refunded) would be computed. The extent to which the taxpayer shifted the burden of the tax to others would be determined. The tax would be based on the portion of this net income which represents the amount of tax burden shifted.

Mr. CROWTHER. That is not new. We all understand that.

Mr. VINSON. I know, but it is on this point.

Mr. CROWTHER. We all understand that.

Mr. VINSON. And it follows a statement by me as to my idea of this tax treatment, and the Commissioner of Internal Revenue hands me the report with that part of it underscored. I think that might be of some benefit.

Mr. CROWTHER. I have it marked here, and several others marked it in the same way. I got it a long time ago.

The CHAIRMAN. I feel, with all due deference to my colleague as a friend and as a member of the committee, that he has, I do not think intentionally, left the Bureau of Internal Revenue and the Commissioner of Internal Revenue by his statement in a very unfair light. He says unless you can show beyond the shadow of a doubt that you have not collected this tax you would be expected to pay it.

I feel, knowing the Commissioner of Internal Revenue as I do—and I would say that of any Commissioner of any administration since I have been here—that if it were a matter in their discretion, unless they were convinced beyond a reasonable doubt, they would not want your money. They are not going to hound you. That is not what they will do. And more than that, you would have the same recourse to the courts that you now have in connection with any

other tax. If there is a disagreement now between a taxpayer and the Bureau of Internal Revenue and an agreement cannot be reached, they adjudicate it in the courts. That would be no new thing. You would have the same opportunity for redress if any injustice were done.

Mr. CROWTHER. Mr. Chairman, I should think it would be the better part of wisdom of this committee to write the law so clearly and so understandably that it might lessen the constant litigation that is appearing in the Treasury Department and the Bureau of Internal Revenue. I should think that we ought to make it very clear. It is only general now.

The CHAIRMAN. I would say to my dear friend that I would join him in a determined effort to do that.

Mr. WERNKE. Mr. Chairman, Mr. Vinson, I believe, made a remark at the first to the effect that we may be afraid of being run over if we go across the street, but that there are signs and everything else warning us of the automobiles. Yet you may go out on the sidewalk and be walking on the sidewalk and still a drunken driver may hit you.

Mr. VINSON. That is not because of fear. What I was trying to illustrate and what I would like to call to the attention of the gentleman is that throughout the years we are presented with folks who have certain fears, and those fears come from various sources. People are skilled in creating fears as well as some folks are skilled in asking questions. But what I wanted to say to my friend was that the subcommittee report, as I read it, as I interpret it, and as I understand it to be interpreted by the Commissioner, dissipates much of your fear.

Mr. WERNKE. Thank you.

The CHAIRMAN. The next witness is Chester G. Newcomb, of Cleveland, Ohio.

STATEMENT OF CHESTER G. NEWCOMB, VICE PRESIDENT AND GENERAL MANAGER, LAKE ERIE PROVISION CO., CLEVELAND, OHIO

The CHAIRMAN. Will you please give the stenographer your name and address?

Mr. NEWCOMB. Mr. Chairman and members of the committee: My name is Chester G. Newcomb. I am vice president and general manager of the Lake Erie Provision Co., Cleveland. That company, Mr. Chairman, has been in business in Cleveland for something like 70 years. My father has been connected with the business for approximately 50 years, a good many years of which he has been president.

We employ somewhere in the neighborhood of 150 to 250 men, depending upon how busy we are at any given time, and are a factor in the packing business at Cleveland.

Much of this time we have never made any more than a modest profit; on the other hand, we have been able to earn a livelihood for ourselves and give employment to some 150 to 250 men, many of whom have been with us for many years.

The processing tax we paid amounted to about \$300,000 with us over a period of about 15 months. The last month that we paid

was for January 1935. This were were not able to pay until about September, and we would not have been able to have kept up payments as long as we did keep them up if it had not been for the leniency of the Bureau of Internal Revenue in granting us time extensions.

Following that, we were able to obtain a temporary restraining order against the collector's distraining our property. At that time the court did not require us to put the money up for the taxes, because they recognized the fact we were unable to put it up. We did not have the cash. If this tax had not been held unconstitutional it would have closed our doors, as well as the doors of every other independent packer in Cleveland, of which there are three more. The only packer left to operate a plant in Cleveland, had that not been declared unconstitutional, would have been the plant of Swift & Co.

One of the four that I mentioned was forced into bankruptcy last June. The same situation, in my opinion, is general as regards the small packers. They have not made money since the imposition of this processing tax. I think if this "windfall" proposal is enacted, and the law stands up, it will be responsible for putting out of business a very large and substantial number of small packers. I think also that it will tend very much to create a monopoly for the national packers.

I support most everything that has been said here by previous speakers representing the small packers. I do think it is a very general situation, and I do not think I have exaggerated it in regard to the number of small packers that are affected.

That is all I have to say, Mr. Chairman.

The CHAIRMAN. We thank you for your appearance and the testimony you have given the committee.

The next witness is E. L. Schneider, of Cleveland, Ohio, representing the Ohio Provision Co.

STATEMENT OF E. L. SCHNEIDER, SECRETARY AND TREASURER OF THE OHIO PROVISION CO., CLEVELAND

The CHAIRMAN. Will you please give your name and address to the reporter?

Mr. SCHNEIDER. My name is E. L. Schneider. I am secretary and treasurer of the Ohio Provision Co., Cleveland. Our business was founded in 1883. I have been connected with the company for 31 years. It is owned by about 25 shareholders. It is an independent company; it gives employment to about 200 men and women; as for size, it occupies about 2 acres of land in the stockyards district.

It has the capacity to handle 3,000 hogs, 300 cattle, and 500 calves and sheep combined per week; total annual sales around \$3,000,000.

We processed hogs under the A. A. A. and come within the scope of the proposed "windfall" tax bill now being considered. We paid about \$500,000 of processing taxes into the Treasury—that is, exclusive of drawbacks.

You may doubt me, gentlemen, when I say that the \$500,000 burden was not all passed on to the consumer. I want to bring out that it absorbed inventory appreciation and profits from our other lines not connected with hog processing. Our inventory from a low level of

livestock prices gradually increased about 200 percent when the level of August 1935 was reached—a level of a great deal of risk. The drought had a great deal to do with that.

Now, for illustration, the processor who paid his taxes and did not have left over the amount of profit that his inventory appreciated and what he made in other lines or enhancements in value, lost that profit, as well as a reasonable margin which he should have in paying processing taxes. Where he had \$1 of inventory value at low prices, he now has three for the same number of pounds.

It has been the experience of the packing industry that it loses as much by declines in values as it profits by rising markets, if not more. This is obvious. Extreme large stocks force prices down and small stocks tend to raise prices, so that the packer stands more chance to lose money on a large amount of product declining in value than he can hope to recon on a small amount of product advancing in value.

It would seem unlikely that there would be a further material advance in livestock prices, surely not as great as we have had; but should the values shrink and gradually decline to a point near the low level, who will reimburse the packer? Instead of \$3 of inventory value, he will have only \$1.

A million pounds of product at 15 cents per pound amounts to \$150,000. A million pounds at 5 cents amounts to \$50,000. Who bears the \$100,000 shrinkage? The packer. Is he not also entitled to appreciation to offset losses?

We must all be agreed that as far back as figures are available markets have gone up and down. Now, take away the profit from any business caused by an advancing market and make it suffer the losses of two declining markets and it will be out of business.

I have seen hogs sell on the Cleveland market at \$23.00 per hundredweight, on the hoof, and then at \$3 per hundredweight, and the product from them in proportion. The advance in prices and tax have more than doubled our trade accounts receivable. The responsibility of the trade—that is, safety as credit risks—or their means out of which to pay has by no means doubled.

Now, getting back to that \$500,000 paid; where did the money come from? The profit from the inventory was not realized; it was paper profit. We just said accounts receivable more than doubled. It did not come from that source. It was possible only by getting extensions of time in which to pay from the collector of internal revenue; putting the payments off, in our case, we paid our February 1935 tax in September 1935.

We were running then about 6 months behind in a 23-month period. I want to spare your time; but I want to say that if the A. A. A. had not been held unconstitutional, we would have been put out of business, and I am thoroughly convinced that if a so-called "windfall" tax is enacted along the lines suggested, we will have to go out of business, and many employees of 25 to 35 years' service will have earned their last day's pay, owing to their having grown old in our employ.

I do not know about the national packers whose names are familiar to you, but some of them, no doubt, had to borrow the money they put in escrow when they secured injunctions. They have many lines and show profits, but when their profits are segregated—that is, their profits from their day-to-day pork operation—and inventory appreciation is not included—they will show very different results.

I am worried about perhaps 100 or more, nearer our size, some larger and some smaller, of whom you may never have heard, and who, from a multiplicity of causes, have been becoming fewer and fewer during the last decade. The majority of these survivors did not put any money in escrow when they secured injunctions, because they did not have the money which they are now presumed to have taken from the public to do it with.

Thank you for the privilege of appearing before you.

The CHAIRMAN. Thank you for your appearance and the testimony you have given the committee.

The next witness is Mark Eisner, New York. He does not appear. R. C. Fulbright.

STATEMENT OF R. C. FULBRIGHT, REPRESENTING THE SOUTHERN PINE ASSOCIATION

Mr. FULBRIGHT. Mr. Chairman and members of the committee, my name is R. C. Fulbright. I reside at Houston, Tex.

I appear here for the Southern Pine Association, which is an association composed of the principal manufacturers of softwood lumber throughout the South.

There are two features of the proposed bill that I wish to discuss, the first of which I shall refer to in only a very few words.

The first feature that I wish to refer to is paragraph 13, where there is a recommendation that dividends paid out of earnings or out of increase in value accrued prior to March 1, 1913, should be fully taxable to the recipients of such dividends.

Out in Mr. Hill's country they have what they call the large lumber companies, but down South we have a lot of small lumber companies. Nearly all of them are small corporations. It is one of the original softwood lumber-producing territories of the country. There are today many companies that have lumber reserves that they have had for 40 or 50 years, some of them longer. It is practically impossible to tell what the cost of some of those companies is.

We feel that to go back and use the March 1, 1913, base to determine whether or not there was an increase in value prior to that date will impose an impossible burden upon some of them, and in all cases it violates what we think is the spirit of the decision of the Supreme Court in declaring that Congress could not tax income accrued prior to the effective date of the sixteenth amendment.

The increase in value prior to March 1, 1913, when distributed by the corporation becomes taxable, and you will have to go back 25 or 30 and maybe 40 or 50 years in order to tell what the base is.

This subject was covered by Mr. Bennet, who appeared before your committee, and I will not undertake to cover it any more except to endorse what he said, and add that as far as our companies in the South are concerned, it will work a very great hardship on some of them.

Mr. COOPER. Mr. Fulbright, just what was your reference to the court decision on this point?

Mr. FULBRIGHT. I do not have before me the reference to the decision, but it held, of course, that you could not tax income accruing

prior to March 1, 1913, because that was the date when the income-tax amendment was ratified.

Mr. COOPER. But the Supreme Court has held we would have a right to tax this.

Mr. FULBRIGHT. I did not say this would be violative of that decision, I said it would be violative of the spirit of it. It is in fact taxing profits which accrued prior to March 1, 1913. But the profit is not the profit of the corporation. You could not tax it as the profit of the corporation. When it is distributed to the stockholder you can constitutionally do it, but I say that it is not right.

Mr. COOPER. I am not discussing the question of right and wrong, I am just making the observation to you that the court has held that we have a right to tax this in the hands of the stockholders.

Mr. FULBRIGHT. You have a right to tax it at the time the stockholder gets it, of course. But I am not disputing that you have the right. What I am saying is that you want to go back 40 or 50 years to determine something that in many cases cannot be determined. It does not seem to me to be fair. Many of the smaller companies will be very unjustly taxed under this proposal, and I wish to illustrate that.

I had a statement made up which I thought would be here, but I just took three assumed companies with \$20,000 income per year, in each of which there were three stockholders—one, Smith, who owned 50 percent of the stock, Jones owning 30 percent, and Brown owning 20 percent of the stock.

I have assumed that each of those stockholders has enough income outside of the dividends he gets from the company to offset all of his exemptions and deductions, so that what he gets out of the company would be taxable.

The "X" company is in good financial condition, and there is no reason why it cannot distribute its earnings. The "Y" company is heavily indebted and must retain a substantial part of its earnings to apply on its debts. The "Z" company desires to retain a minor proportion of its earnings to make needed improvements in its plant.

In each of these cases it is assumed that each stockholder will have his distribution from the company taxed as his income. It will all be taxable.

In the case of the "X" company, which distributes all of the \$20,000, the total individual taxes will be \$1,180. There will be none against the corporation under this proposed bill.

The "Y" company, however, feels that it can distribute only half of its income, as it owes a lot of debt—and we have lots of them that are very heavily indebted. If it distributes one-half of its income, the individual taxes plus their share of the corporate taxes will be \$7,440, or more than six times the amount of taxes borne by those who were in the more fortunate company.

The "Z" company, which wishes to lay aside 30 percent of its income to make needed improvements in its plant—and we have lots of them that need to make those improvements—will distribute \$14,000 of its \$20,000 income, and the total taxes paid by the stockholders in the corporation will be \$3,698, more than three times the amount of the corporation which was in a fortunate circumstance where it

did not have to retain money for needed improvements or to apply its debts.

We believe that that is a discrimination between different corporations. It works a hardship on the corporation which is in an unfortunate financial condition. It is true that in your report you have recommended a provision that where a corporation has prior to January 1 of this year a bona-fide contract of a creditor under which it is obligated to pay no dividends until a certain amount of its indebtedness is paid, it may credit that against the income which is taxable under this schedule 2, but that would happen only in extreme and isolated cases. They may be under moral obligations, but it is very seldom in the ordinary course of business of the ordinary small concern that the banks would even require them to so tie themselves up with a contract of that character. Yet they owe these moneys; they have to make these improvements.

When this matter first came before our members—and by the way, I have just come from the annual meeting of the association in New Orleans, where the whole subject was discussed—many of them thought that this would be a very great reduction in taxes to them, and, indeed, it will be to quite a few of them.

If you take a company where they have only three or four stockholders, all working together, by distributing all of the money and then paying it back as paid-in surplus into the corporation they will come out with a minimum of tax, and they will pay very much less taxes in the usual case than they do under the existing law.

For example, in the first case I gave you, today under the present law they would pay \$3,020 taxes, and under the new law they would pay only \$1,080.

Mr. DIXON. Would you mind stating those figures again?

Mr. FULMIGHT. Under the present law, in 1936, the total corporate and individual taxes in the first case I mentioned, where they distribute all their earnings, would be \$3,020, whereas under this bill the total taxes would be only \$1,080.

So there would be cases where they would pay very much less taxes, but there are so many cases where there are some stockholders, or one stockholder, perhaps, a man having a beneficial interest in some of the stock, who would not be willing to pay back as paid-in surplus the dividends received, that they would find it would be impracticable to work that focus point on it and get out of the tax.

Moreover, where they are in position to pay the money back in as paid-in surplus, they will gradually build up the basis of the cost of their stock, so that when they finally cut out all the timber and liquidate their properties, they will have less income tax to pay to the Government, because they build up their cost basis by paying in the surplus.

But in spite of the fact that some of them felt they might get benefit out of it, the opinion was practically unanimous among them—there was no dissent voiced—that it was not a good policy to have a law that would virtually compel them to distribute all they make every year.

In the case of the company that wanted to withhold 50 percent of its income to pay on its debts, I call your attention to this fact, that out of that 50 percent that it retains, or \$10,000, it will have

to pay \$7,000 to the Government. It will have only \$3,000 to pay on its debts. It will not be a bit better off in that respect than if it had distributed 70 percent of its income, because the way it figures out, it will have just 15 percent of it left. Whether it distributes 30 percent or 50 percent of its income, it will have just exactly 15 percent of it left, after it gets through paying off the Government.

Of course, that means that there are going to be a great many artificial readjustments made there in order to avoid the taxes, but there will be numerous companies that will be greatly penalized because of the necessity that they face of withholding a substantial part of their income. And there are little companies, mind you.

I also took some illustrations where they had outside income. I assumed companies with the same amount of income, \$20,000, a pretty good income for the ordinary little lumber company in the South. I assumed that Smith had \$20,000 outside income, Jones \$4,000, and Brown \$10,000, and then they received the same amounts of dividends as in the other three cases.

There, of course, by reason of the fact that Smith gets \$10,000 dividends of the X company, added to the \$20,000 he already has, it makes it cost him more taxes. It costs him \$2,140 more taxes than if he did not have that dividend of \$10,000.

If he had been in the Y company with that \$20,000 income it would have cost him \$4,510 more, or more than double as much, because unfortunately the Y company is not in a financial position to distribute its earnings as dividends to its stockholders.

In other words, the effect of this is to put a penalty on the company that finds itself either in financial difficulties or with a plant that needs to be modernized and brought up to date in order to keep it in the running, whereas the company that is already in good shape and has a closely knit group of stockholders can get out with the minimum of tax liability.

In the case of the other illustration I gave, where only 30 percent of the income is retained, Mr. Smith, Mr. Jones, and Mr. Brown pay a total of over \$5,000 taxes, although they have outside income aggregating over \$34,000.

I would like to furnish for the record the statement which I have prepared, which gives the details of this, in order that the members of the committee may have it.

(The statement referred to follows:)

STATEMENT BY H. C. FULMIGHT, SHOWING EFFECT OF PROPOSED REVENUE BILL OF 1936 UPON STOCKHOLDERS OF SMALLER CORPORATIONS

The comparisons listed below are for convenience based upon an assumed situation where each corporation has three stockholders, Smith with 50 percent of the stock, Jones with 30 percent, and Brown with 20 percent. Each has net income of \$20,000 before payment of income taxes.

The X company is in good financial condition and there is no reason why it cannot distribute its earnings; the Y company is heavily indebted and must retain a substantial part of its earnings to apply on debts, while the Z company desires to retain a minor proportion of its earnings to make needed improvements in its plant.

In each of the above cases it is assumed that each stockholder has outside income only to the extent of his exemptions and therefore that the dividends received will constitute the only income subject to tax.

In order to show the situation where stockholders would have a substantial outside income, we have added three further comparisons designated the A company, B company, and C company, respectively, in which the proportion of earnings distributed corresponds respectively to that shown in the X company, Y company, and Z company, but in each of the cases the stockholders have substantial outside taxable income. The comparisons follow:

Stockholders	Dividend received	Individual taxes	Share of corporate taxes	Total taxes
X company (distributes 100 percent of income)				
Smith	\$10,000	\$700	None	\$700
Jones	5,000	320	None	320
Brown	5,000	360	None	360
Total	20,000	1,380		1,380
Y company (distributes 80 percent of income)				
Smith	5,000	240	\$3,500	3,740
Jones	3,000	120	2,100	2,220
Brown	2,000	80	1,400	1,480
Total	10,000	440	7,000	7,440
Z company (distributes 70 percent of income)				
Smith	7,000	410	1,500	1,910
Jones	4,200	176	900	1,076
Brown	2,800	112	600	712
Total	14,000	698	3,000	3,698

Stockholder	Outside income	Dividend received	Added individual tax	Share of corporate taxes	Total taxes
A company (distributes 100 percent of income)					
Smith	\$25,000	\$10,000	\$2,140	None	\$2,140
Jones	4,000	5,000	540	None	540
Brown	16,000	5,000	400	None	400
Total	45,000	20,000	3,080		3,080
B company (distributes 80 percent of income)					
Smith	20,000	5,000	1,010	3,400	4,410
Jones	4,000	3,000	250	2,100	2,350
Brown	10,000	2,000	220	1,400	1,620
Total	34,000	10,000	1,480	7,000	8,480
C company (distributes 70 percent of income)					
Smith	20,000	7,000	1,370	1,500	2,870
Jones	4,000	4,200	360	900	1,260
Brown	10,000	2,800	315	600	915
Total	34,000	14,000	2,045	3,000	5,045

Mr. FULBRIGHT. We consider that it would be a very great detriment to our smaller companies unless some way can be found to protect the company that is heavily indebted or the company that must in order to keep going make needed improvements.

I believe the committee has undertaken in a way to reach that.

We read a lot in the papers about the cushion, but the cushion as yet is not soft enough to take care of a lot of them who have been very hard hit during these recent years of the depression.

Mr. McCORMACK. You think they would need a bed, do you not, instead of a cushion? That is just facetious.

Mr. FULBRIGHT. If this bill is put through, the most of them are going to go into receivership, because then they will have to pay only 15 percent, and the rest of it can go on the payment of their debts. You will find that hundreds of them will go into receivership. Some of us lawyers will reap the benefit of it; but I do not think that is good tax policy.

Mr. WOODRUFF. In other words, you believe this cushion at the present time is composed only of a covering, there have been no feathers put into it yet?

Mr. FULBRIGHT. It would be pretty hard sitting for some of those who—

Mr. WOODRUFF. At least, it has not been properly upholstered as yet!

Mr. FULBRIGHT. I should not say that. There are numerous cases where that cushion should be of very great importance. There are many companies where, if they can retain 20 percent of their income, that will be ample for them. But I am talking about a small company that does not have much income, that is burdened with debt.

I am a minority stockholder in a company that made a little less than \$1,500 last year, net, and it owes over \$40,000. Under this bill you would take 30 percent of that, or else we would have to just distribute it among the stockholders and pay it back in, which perhaps we would do, if we did not have some fellow that kicked against it. If one stockholder objects to that, the only way you can get around that is to lend the money back to the corporation and build up another liability of the corporation, and thereby further impair its credit.

Mr. WOODRUFF. Is it your opinion that if this bill is enacted as proposed it will prove a detriment to any one even thinking of engaging in a new enterprise in competition with enterprises already in existence, and fortified, perhaps, with adequate reserves?

Mr. FULBRIGHT. It will if they have to undertake any large indebtedness in connection with the enterprise. They would have to be quite well heeled to start with in order not to be at a disadvantage.

Mr. WOODRUFF. It has not been the experience of American business, has it, for new enterprises, little enterprises, to be any too well heeled when undertaking any new activity?

Mr. FULBRIGHT. I should say from my observation most small enterprises have to start at the bank. They have to arrange for a certain amount of credit to conduct their operations. They usually have to have something for their plant, and then in order to finance a going concern, the sale of their goods until they can collect the money, and the meeting of their pay roll, they have to borrow money at the bank or somewhere. That kind of institution, I believe, would be at a disadvantage as contrasted with the institution which already had ample working capital.

Mr. WOODRUFF. It is your opinion that the effect of this bill will be to place the business of the country gradually within a smaller group from time to time? In other words, will it in effect put into the hands of the larger, more prosperous corporations of the country, a greater share of the American business?

Mr. FULBRIGHT. Undoubtedly this bill would be little or no handicap to many large corporations. It would probably be an advantage

tage. It would be an advantage to some of these small corporations. But the policy of it in the long run would be to make it impossible or impracticable for companies to maintain a surplus reserve, and when the rainy day comes, they will have nothing to carry them through.

When that rainy day comes, they are going to close down and all of their men will be out of employment.

I believe that the law should be so framed that suitable reserves may be built up in any business, and that they may be encouraged rather than discouraged.

Mr. WOODRUFF. In other words, you believe that if this bill should become law, when the rainy day comes many of these smaller corporations that you speak of that have not been able to lay aside proper reserves will follow the exact road that has been followed by so many fine small business institutions that have passed completely out of the picture during the last 5 or 6 years in this country. Is that your opinion?

Mr. FULBRIGHT. I think they will.

Mr. WOODRUFF. That is all, Mr. Chairman.

The CHAIRMAN. You speak of the disadvantage at which the small companies might be placed as a result of this bill, and feel that they should have some special consideration in the way of taxes in order that they might build up these reserves in order to prepare for a rainy day.

Would you think that they are any more entitled to that special consideration in the way of taxes than the individual or the partnership doing business which might be in the same situation? When the rainy day came they also might need reserves and be put out of business, as my good friend, Mr. Woodruff, suggests. Would you want to say that?

Mr. FULBRIGHT. This, of course, has the effect of putting the corporations a good deal in the order of partnerships, I recognize that.

The CHAIRMAN. So far as taxes are concerned you favor giving them a preferential treatment?

Mr. FULBRIGHT. I do not think there should be preferential treatment, but, mind you, partnerships have certain advantages that corporations do not have.

The CHAIRMAN. And mind you, corporations have certain advantages that partnerships do not have. You do not deny that, do you?

Mr. FULBRIGHT. The corporation is the most vulnerable creature on earth to all kinds of taxes, from the States, municipalities, and what have you. This does take the load of taxes off the corporations as such, provided those corporations are so fixed that they can distribute that; and of course, to that extent it puts them as though they were all partners, rather than stockholders.

The CHAIRMAN. You would admit that there are certain advantages that accrue to corporations or men engaged in business in corporate form, or they would not form a corporation.

Mr. FULBRIGHT. Yes; there are advantages.

The CHAIRMAN. They would operate as individuals or partnerships if it was not to their advantage to incorporate. So your idea

does not get them anywhere as against individuals or partnerships—otherwise, there would be no corporations.

Mr. FULBRIGHT. In some lines of business it is of tremendous advantage to have a partnership rather than a corporation. In other cases it is of advantage to have a corporation. But in either case I do not think the law should be so framed as largely to take away from them the opportunity to build up reserves against a rainy day. I do not think it does that today against the ordinary partnership of this size that is doing a business such as I described here.

The CHAIRMAN. Will not the individual and the partnership have to pay the normal taxes and the surtaxes? This contemplated tax bill has for its purpose only putting the partnerships and the corporations as nearly as may be—it cannot be done exactly—on the same basis so far as paying taxes for the support of the Government is concerned.

Mr. FULBRIGHT. Mr. Chairman, in the first illustration I gave you, today a partnership of those three individuals earning that same money would pay \$1,180 taxes. Today the corporation earning that same money would pay \$2,640 taxes. Already the corporation is taxed much more on the small businesses than the individual partnership. When you get to very large organizations you will find that the reverse is true. You cannot lay down one rule to fit all cases.

The CHAIRMAN. You just gave an exception. You would not contend that that is the general rule? The case you have just cited is a rare exception.

Mr. FULBRIGHT. Oh, I beg your pardon. I suppose there are probably more than half in number of the lumber manufacturers of the South that are operating as partnerships, and they find it to their financial advantage to do so.

The CHAIRMAN. Perhaps they are not making much money, and they do not pay very high surtaxes.

Mr. FULBRIGHT. I grant you when you get into the large businesses they are different, but, again, when you get into the very large business some of the very largest concerns do distribute practically their entire income as they go along, and there your cushion, no doubt, of 20 percent or 30 percent would be ample. But it is not ample when you take a business that is a small concern to start with and has a heavy burden of debt or has important improvements to make.

My objection to the bill is that you are laying down one arbitrary rule to try to fit every business concern. That is going to work a lot of injustice on a lot of companies.

The CHAIRMAN. I do not think so.

Mr. FULBRIGHT. These figures I have given you will best illustrate that. I hope you will look them over carefully.

I thank you.

The CHAIRMAN. We thank you for your appearance and the testimony you have given the committee.

The next witness is R. V. Fletcher, Washington, D. C., counsel of the Association of American Railroads.

STATEMENT OF R. V. FLETCHER, COUNSEL FOR THE ASSOCIATION OF AMERICAN RAILROADS

The CHAIRMAN. Will you please give your name to the reporter?
Mr. FLETCHER. My name is R. V. Fletcher. I live in Washington.
The CHAIRMAN. You appear in the capacity of attorney for the railroads?

Mr. FLETCHER. I am counsel for the Association of American Railroads.

The Association of American Railroads is a voluntary association embracing, I should say, about 98.5 percent of the mileage of the class 1 railroads of the country. It is not to be confused with the Short Line Railroad Association, the presentation of the views of which will be made by another gentleman.

I have no thought, Mr. Chairman, of discussing this bill in its fundamental aspects or dealing with any economic or political questions which may underlie the plan, taken as a whole. I want to limit what I have to say to some observations with reference to the plan as applied to the railroads, not with a view of suggesting that the plan be rejected but in the hope that I might convince the committee that some changes should be made in the plan on account of the peculiar attitude and situation of the railroads.

I want to express to the committee and to the Congress our expression of profound and sincere gratitude for having retained in the plan the principle of having a consolidated return on behalf of the railroads; that has proven to be a very great advantage, for which we are very grateful.

We are also under obligations to the subcommittee that reported this plan for reducing the amount of the capital stock tax by 50 percent. In these days of meager earnings on behalf of the railroads, the capital stock tax has perhaps been the most burdensome form of taxation to which in the last 2 or 3 years they have been subjected.

The CHAIRMAN. You understand also that after July 1, the capital stock tax is entirely removed?

Mr. FLETCHER. Yes; that is true.

This is, I understand, only retained at one-half of its present figure as a sort of an interim arrangement until this permanent plan can be put into effect.

I think I might just preface what I have to say by saying that the railroads do make a substantial contribution to the expenses of Government, both National and State, in the way of taxes. There has been, in the case of the railroads, as indeed, in the case of all industry, I take it, a very great increase in the amount of taxes in relation to revenues in recent years.

The proportion of the burden of taxation to the dollars of railroad revenue has been constantly increasing.

In 1916, out of every dollar taken in by the railroads, they paid out 4.4 cents, or 4.4 percent of their revenue in taxes.

In 1929 that had increased to 6.3 percent, and in 1935 to 6.8 percent. Out of every dollar, therefore, of railroad revenue in 1935 the railroads paid 6.8 percent.

Mr. DINGELL. Will the judge yield there for a question?

Mr. FLETCHER. By all means.

Mr. DINGELL. That was a percentage figure that you gave?

Mr. FLETCHER. That was a percentage figure; that is right.

Mr. DINGELL. Has not that increase in taxes been due to the fact that there was a downward trend in revenues and the volume of business generally?

Mr. FLETCHER. That has contributed very largely to that, Mr. Dingell, but it has not been the only reason. Of course, governmental expenses generally have increased, as we all know.

Mr. DINGELL. I realize that there was some material increase there, but that rise from 4.4 percent to 6.8 percent was not necessarily due to the increase in taxes?

Mr. FLETCHER. Not entirely attributable to that; not, I should say, more than one-half of the increase was attributable to that fact but to the fall in revenue. Therefore, the relative burden, as between 1916 and 1935, has increased 55 percent.

Stating it another way, and a way in which it might be a little better apprehended, if you look not at the gross revenue of the railroads but at their net revenue or net operating income, which means, of course, the income of the railroads after they have paid their operating expenses and before taxes have been paid and before fixed charges have been met, 13.1 cents out of every dollar was absorbed by taxes in 1916 and 32 cents out of every dollar was absorbed by taxes in 1935—I am talking now about the net—which was an increase of 145 percent.

That is to say, the railroads in 1935 paid in taxes about one-third of the amount of their net operating revenue.

Mr. McCORMACK. What did you say it was in 1916?

Mr. FLETCHER. In 1916? You are now talking about net revenue, Mr. McCormack?

Mr. McCORMACK. Yes.

Mr. FLETCHER. It was 13.1 cents out of every dollar.

Mr. McCORMACK. What was it in 1929?

Mr. FLETCHER. In 1935—

Mr. McCORMACK. No; in 1929. Can you break that down?

Mr. FLETCHER. I have the 1929 figures for the gross, but not for the net.

Mr. McCORMACK. That is why I was curious. You had it for the gross, and I was wondering why you did not have it for the net.

Mr. FLETCHER. I do not know that there is any special reason.

Mr. McCORMACK. I just wanted to get an idea.

Mr. FLETCHER. I shall be very glad to supply that.

Another way to understand the tax bill of the railroads in 1935 is to say that for every carload of freight which was loaded in that year there had to be paid \$5.44 in taxes; that for every person employed by the railroads in 1935, there was paid out \$238 in taxes.

The total tax bill of the railroads in 1935—and it was not so much as it has been in some previous years—was \$236,793,115.

Mr. McCORMACK. Judge, I think it is fair to break those down for each year. I think you ought to go back. Now you are going back to 1916. I thought you ought to break them down and show what those costs were per year, so as to give the complete picture.

Mr. FLETCHER. I can do that, Mr. McCormack.

Mr. COOPER. Then it might also be helpful there, Judge, if you would kindly break it down as between Federal and State.

Mr. FLETCHER. I can make a statement, Mr. Cooper, in a general way. I cannot break it down by figures, but I can say that the taxes which are collected by the local governments, State, municipal, and county taxes, have been very much greater relatively than the taxes of the Federal Government, very much greater, because, as you readily understand, the railroad net income has almost disappeared in recent years, and therefore the income tax payable to the Federal Government has been very greatly reduced.

Mr. VINSON. What is the relation in percentage between the Federal tax and the non-Federal tax?

Mr. FLETCHER. In amount, you mean?

Mr. VINSON. Yes, sir.

Mr. FLETCHER. The amount paid to the Federal Government in 1935, as compared with the amounts paid by the railroads to local governments, meaning thereby State, county, and municipal governments, did not amount to more than one-fifteenth of the total amount. That is a little guess, and I would be glad to supply that more accurately to the committee, but I think I am safe in saying that. I will see if I cannot give these figures on the taxes for the record, Mr. McCormack.

Will you let me file that with the committee? I do not seem to have it before me.

Mr. MCCORMACK. I did not ask you for it now, Judge. You see, those figures give the impression that the Federal Government was getting all these taxes.

Mr. FLETCHER. I say with all candor and very frankly, that that is not true. I am just talking about the general tax burden, for which this Congress is in no way responsible, so far as I know.

I thought it might be interesting to know that the railroads do pay out in all taxes \$648,748 every day, and in normal times, that amounts practically to a million dollars a day. This figure that I gave you here was in a period of considerable depression.

I want to call attention briefly to what seems to me to be two significant peculiarities of the railroad industry which I think ought to be considered by the Congress in undertaking to appreciate the application of this tax plan or, indeed, any other, to the railroad industry.

One is the very significant fact that the railroads constitute public-service corporations; or, to use the common language of the lawyer, it is a business affected with a public interest. That means that in the course of the 50 years during which they have been subject to Federal regulation their rates have been regulated, their accounting practices have been regulated, their services are regulated by State and Nation—particularly by States, I should say—and their wages are, after a fashion, regulated, so that they have not much opportunity to exercise any degree of judgment or initiative with respect to any of the factors which might determine taxation.

Their rates are fixed by the Interstate Commerce Commission, as we all know, and therefore no opportunity has been given through the process of increasing rates to accumulate reserves or resources which might be used to meet the exigencies of a rainy day or to take care of

the retirement of their obligations or to do any of the other usual things which prudent businessmen sometimes think are desirable.

To show that that is not an extravagant statement I would like to call attention to the rates of return upon the investment of the railroads in road and equipment by decades over a period of years:

In the 10 years from 1890 to 1899, inclusive, the rate of return of railroads was 3.79 percent upon the investment in road and equipment, which means the book value of the railroad property.

In the 10 years from 1900 to 1909 that ratio had increased to 5.24 percent, and that was the most profitable period of railroad operations since 1890, if profit is measured by the rate of return upon their property investment.

In the decade from 1910 to 1919 that figure fell to 4.39 percent.

In the period from 1920 to 1929 the figure was 4.08 percent, and in the period from 1930 to 1935, taken as a whole, the average was 2.06 percent.

In other words, in the period of so-called prosperity, extending from 1920 to 1929, the railroads were able to make a little more than 4 percent on their investment.

If anybody should suppose that the investment figure was not a proper figure or basis upon which to calculate income, I should like to say that the valuation of the railroads as made by the Interstate Commerce Commission after the deduction of very considerable amounts for depreciation shows figures of very little more than those which I have just read into the record.

Mr. MCCORMACK. You say book value, Judge?

Mr. FLETCHER. These figures I gave were on book value.

Mr. MCCORMACK. What about the paid-in capital?

Mr. FLETCHER. If you mean by "paid-in capital" the amount of the investment of the public in railroads, meaning thereby the total of their outstanding stocks and bonds, measured at par, you can get some idea of that by remembering that at present the total amount of outstanding stocks and bonds is \$19,000,000,000.

Mr. MCCORMACK. I thought it was about 20, somewhere around that.

Mr. FLETCHER. The valuation of the Interstate Commerce Commission is about \$22,000,000,000, and the book value of the property is about \$26,000,000,000.

In addition to the very severe regulations which have been imposed by public authority upon the rates, upon their service, and upon their wages, I would like to call attention to the peculiarity of the railroads with respect to their accounting. When I say "peculiarity", I mean I think it is different from the accounting which is commonly employed in ordinary industry. The accounting rules of the Interstate Commerce Commission control the railroads absolutely in the making of their accounts, and the effect of that has been to require charges to capital in the case of the railroad industry which would not be necessary were not its accounting so closely supervised by public authority.

I think the accounting requirements of the Interstate Commerce Commission with respect to this feature that I am now attempting to discuss are very different from those which prevail in many very well-conducted private enterprises.

I mean by this that if you have a switch stand on a railroad which has to be renewed because its service life has been exhausted, and that switch stand cost, we will say, \$200, 20 years ago, and it is necessary now to replace it with a new one which is of the same type, or at least performs the same function, and it costs \$400, under the accounting rules of the Commission you charge only to operating expenses the book value of the old or discarded device, which would be \$200, and you charge to your capital account the full amount of the cost of the new device, \$400, and then credit your capital account in turn, \$200.

The net result of all that is that you have increased your capital account by \$200, although you have not increased the earning power of your plant or done anything else but to replace in kind a device of that sort.

The same thing would be true of a bridge or of a building, or of rough other of the equipment of the railroads which has to be renewed from time to time.

I think we can illustrate the results of that in this way:

Let us suppose that you have a railroad which has a gross income in a year of \$100,000,000, as many of them do, of course. It is found that you have expended \$80,000,000 of that \$100,000,000 in operating expenses, in taxes, and in interest upon your outstanding obligations.

There would be then, as I understand it, subject to taxation under this plan, \$20,000,000.

Mr. McCormack. Does that include depreciation and all other charges?

Mr. Fletcher. Depreciation is charged to operating expenses if you set up depreciation, as most railroads do upon equipment and as practically no railroad does upon road and structures.

Mr. McCormack. You mean, practically no railroad does on road and structures?

Mr. Fletcher. Very few, Mr. McCormack.

Mr. McCormack. Can you tell me just briefly why? I do not mean to interrupt the continuity of your thought.

Mr. Fletcher. That has never been done. It is a long story, but boiled down to the briefest compass, it is that most railroads have found themselves unable to do so by reason of shortage of funds.

Mr. Hull. Would not the cost of maintenance be an item deductible from your gross to get your net income for tax purposes?

Mr. Fletcher. Of course, maintenance is chargeable to operating expense, and would be in the \$80,000,000, just ordinary maintenance.

Mr. McCormack. Would not the depreciation of the road be a deductible item?

Mr. Fletcher. It would be a deductible item if the roads had set up depreciation, but they have not, a matter which I would like to refer to a little more in detail in a moment.

Mr. Vinson. Let us stay by your illustration, Judge. You have \$100,000,000 gross income?

Mr. Fletcher. That is right.

Mr. Vinson. And you have \$80,000,000 operating expenses?

Mr. Fletcher. And taxes and interest. Depreciation I include in operating expense. In other words, you have \$20,000,000 which, as I understand it, would be taxable income.

Mr. Vinson. Would that \$20,000,000 be what we would call the adjusted net income?

Mr. Fletcher. Precisely. I forgot to use the right word, "adjusted", there, as used in this plan. You have the adjusted net income of \$20,000,000. And yet that railroad has only \$10,000,000 cash in its treasury as a result of its year's operations, for the reason that \$10,000,000 of that has gone into additions and betterments under the accounting rules of the Commission by reason of the necessity of charging to capital account a certain amount of these replacements which represents cost greater than the cost of that which was replaced.

So that here is the railroad company with \$10,000,000 to pay dividends with, and yet chargeable under this bill, as I understand the bill, with 42.5 percent—is that the maximum?—upon \$10,000,000. So they would have to pay 42.5-percent tax upon \$10,000,000 which had gone into capital account under the accounting rules of the Commission without any real increase in the earning power of the railroad, unless you say earning power is increased by substituting new structures for old.

Mr. Vinson. You are assuming that \$10,000,000 was distributed in dividends.

Mr. Fletcher. You would have \$10,000,000 there, Mr. Vinson, which would be distributable in dividends if you did not have to take 42.5 percent of it to pay the tax on this other \$10,000,000.

Mr. Vinson. Your base is your adjusted net income, that is, \$20,000,000?

Mr. Fletcher. That is right.

Mr. Vinson. So it would be 42.5 percent of your \$20,000,000?

Mr. Fletcher. Not if you paid \$10,000,000 of it in dividends.

Mr. Vinson. That is the reason I asked you if you were assuming that \$10,000,000 had been distributed in dividends.

Mr. Fletcher. Yes; that is right. Then you would have to go somewhere, I do not know where, to get money to pay the 42.5 percent upon your \$10,000,000 investment in property. That is a peculiarity of the railroad industry. I am not suggesting that as an objection to this bill at all, but in order to lay the background for one or two suggestions that I would like to make to the committee.

Mr. Cooper. I would like to invite your attention to this point, Judge: If you distribute \$10,000,000 in dividends, you would not charge the 42.5 rate because you would have distributed 50 percent.

Mr. Fletcher. I was not sure that I had used 42.5 percent correctly. I had not analyzed that far enough to know just what the rate would be under the bill.

Mr. Cooper. I think that would be 35 percent.

Mr. Fletcher. Thirty-five percent. I accept the amendment, Mr. Cooper. Thank you for the correction.

Mr. Vinson. I take it for granted that that is a substantial amount?

Mr. Fletcher. I would think so. That would require you to go out and borrow \$3,500,000 there from some source or other.

Mr. Crowther. The suggestion was that you were not as badly crippled as you thought, you lost only one leg instead of two.

Mr. FLETCHER. I think a little more than one, perhaps; about a leg and a half.

Mr. McCORMACK. Not to disappoint you, Judge, but I think it would be \$7,000,000, which is 35 percent of \$20,000,000.

Mr. FLETCHER. Perhaps so. I leave that to you expert gentlemen. Anyway, it would be a plenty.

No; I think not, Mr. McCormack. You would not have 35 percent, if that is the right figure, on the \$10,000,000 you distributed, would you?

Mr. McCORMACK. On the statutory net income and what is retained for a surplus linked up. The rate on the retained is not on the retained alone, it is on the statutory net income.

For example, if you retain 50 percent and the rate is 35 percent, according to the proposed bill it would be 35 percent on the statutory net income.

Mr. FLETCHER. It would be both legs and both arms, too.

Mr. CROWTHER. I want to say that while that is stated very clearly in the language, still you have to read it two or three times before you really get it. I have talked with several people who were much mistaken and thought it was figured on the undistributed net rather than on the adjusted net.

Mr. COOPER. Did you ever see any tax language to which you did not have to do that?

Mr. CROWTHER. I hoped we might write one once where the real facts were not disguised with language, where the purpose was not to conceal with language the real purpose and intent.

Mr. FLETCHER. I have no doubt that will be taken care of. I assume that will be taken care of before the bill is written, and that it will be made perfectly clear.

The CHAIRMAN. There certainly can be no misunderstanding of this language.

Mr. CROWTHER. No; I say it is written very plain.

The CHAIRMAN. It is blue printed; it is diagrammed.

Mr. FLETCHER. I was, in thinking what I might profitably say to the committee, not so concerned with the exact figures, but to illustrate the point which I was making about the situation of the railroads.

Another peculiarity of the industry—perhaps it might be considered a peculiarity—is that it is by no means a static industry. It is subject to constant fluctuations, growing out of the fluctuations of the traffic and the rise and fall in the amount of business; and the changes which occur in a rapidly changing business situation.

Railroads are built very often to serve a certain special and temporary source of traffic. They have to be taken up again when that traffic disappears.

Particularly at this time, as you all know from your general knowledge of the subject, the railroads are going through quite a transition stage, particularly with reference to the type of equipment which they find it necessary to provide to meet with modern conditions. The general tendency has been toward lighter equipment, especially in passenger traffic, to trains which are run very much more rapidly than before, and perhaps for the substitution of one kind of motive fuel for another kind of motive fuel. Thus we have the Diesel engines and with them light trains and the like.

Mr. VINSON. Judge, could you tell us what percentage of value are the railroads which are in receivership?

Mr. FLETCHER. Yes; 28 percent of the mileage.

Mr. VINSON. 28 percent of the mileage; but what about your capital investment?

Mr. FLETCHER. It would be somewhat less than 28 percent, I am pretty sure, but not a great deal less. I would imagine about 25 percent, maybe 22 percent.

Mr. VINSON. You understand that as to the treatment of the corporation which is in receivership, it has the flat rate of 15 percent?

Mr. FLETCHER. Yes; I believe it is 15 percent. I had not, as I say, watched these percentages quite so closely.

There is, therefore, the necessity, as much so in the railroad industry as any other, and perhaps a little bit more, for the railroads, in order to carry on the competitive struggle in which they are now desperately engaged, to have some means of adapting themselves to changed conditions, to increase the speed of their trains, and to give a more efficient service if they are to retain what traffic they now have.

I think the committee understands that in spite of assertions to the contrary, a very considerable amount of railroad traffic has gone on to the highways in recent years, more, I think, than the average citizen realizes; not more, of course, than this committee realizes.

I might say in passing, without taking time to elaborate it, that not only would it be of great advantage if the railroads had funds with which to purchase that new equipment and to conform their practices and their methods to modern conditions, but if they were in the market at the present time for that equipment, if they were able to spend the money which they perhaps ought to spend in the taking up of their deferred maintenance and in buying new equipment, so that they might be better qualified to compete, the effect upon the durable goods industries would be very marked, indeed.

I think those figures as to how much the railroads have expended in the way of capital investment and expenditures for the several years have been before the committee, perhaps, in other connections, but it may be significant to recall that the capital expenditures of the railroads in 1920 were \$872,000,000, and that since that time the expenditures have gone down on an average for the last 2 or 3 years to something like \$200,000,000.

Mr. VINSON. Judge, did you give the taxable net income of the railroads for 1935?

Mr. FLETCHER. No; I have not given that, Mr. VINSON.

Mr. VINSON. What is your latest year?

Mr. FLETCHER. The 1935 figures would be pretty complete; 1935.

Mr. VINSON. You say you do not have those figures, or have you those figures?

Mr. FLETCHER. I do not have them here before me; no.

Mr. VINSON. Could you give us the income as to those roads showing net income and those showing deficits—because we have to have it both ways—for 1935?

Mr. FLETCHER. Yes. For each railroad, you mean?

Mr. VINSON. I was not asking you for each railroad.

Mr. FLETCHER. For the railroads as a whole?

Mr. VINSON. For the railroads as a whole, so much net income and so much deficits.

Mr. FLETCHER. I would be very glad to do that. There would be no difficulty at all.

Mr. VINSON. Then we would know the base upon which to apply the tax rate.

Mr. FLETCHER. That is right. I will be glad to supply that to the clerk of the committee.

Mr. McCORMACK. A very limited number of railroads declared a dividend last year, did they not?

Mr. FLETCHER. Oh, yes; very few. I could almost name them from memory.

Mr. McCORMACK. About four, not more than five?

Mr. FLETCHER. The Union Pacific declared a dividend, the Chesapeake & Ohio, the Norfolk & Western, and the Virginian. Those are the so-called Pocahontas-coal carrying roads. The Pennsylvania declared a small dividend. They have great pride in their dividend record, you know.

Mr. VINSON. What about the Louisville & Nashville?

Mr. FLETCHER. Not for years. They made their fixed charges, all right, but no dividends. My general familiarity with the railroad situation would practically enable me to declare from memory what railroads had declared dividends and what had not. There were very few.

Mr. McCORMACK. I knew they were very few.

Mr. FLETCHER. Very few. None in New England, Mr. McCormack.

Mr. McCORMACK. I know that. Of course, the New England railroads are influenced greatly—that is, the New Haven—by the Pennsylvania. We have a personal quarrel up there.

Mr. FLETCHER. Yes; I know about that. That would be an interesting subject for debate, Mr. McCormack, but hardly here, I suppose.

Somebody here sotto voce reminded me that the Bangor & Aroostook declared a dividend. I think the gentleman is right.

Mr. VINSON. Could you give us the amount of dividends declared in 1935?

Mr. FLETCHER. I could not do that from memory.

Mr. VINSON. I mean, in a later statement?

Mr. FLETCHER. Yes; I will be delighted to do that. We have all those statistics in our association.

I want to put into the record a statement as to the amount of the funded debt of the railroads, which in 1935 was \$10,581,300,000, and the par value of the capital stock of the railroads, which is about \$8,500,000,000, which indicates a ratio of funded debt to the entire outstanding capitalization of the railroads of about 56 percent. I have the impression that the ratio in ordinary industry of interest-bearing debt to the total capitalization is about 20 percent, which furnishes an additional reason why this railroad business is peculiar from the viewpoint of the assessment of taxes.

I could go into reasons why the railroad industry has so large a funded debt. I am not apologizing for it. There are very good reasons why that has happened. However, I do not know whether that would be of much concern to the committee. I think it does not indicate any great lack of sound judgment or management on the part of the railroads, but, rather, the fact that they have been

held down by public authority in the days when they had a monopoly of transportation—and they did have practically a monopoly of transportation for a long time—by the decisions of the Interstate Commerce Commission rendered in the public interest, I assume, so that they could not very well accumulate large reserves for the retirement of their bonded debt.

There is a further fact which candor compels me to assert, that very often railroads could borrow money, and the interest on the money that they could borrow would cost them less than what they would have had to have paid if they had been able to sell their stock and had paid dividends upon that stock.

I mean by that awkward statement of mine that, taking the railroad debt as a whole, the rate of interest is about 4.5 percent, and you could hardly hope to sell stock to anybody with the statement to him that the best he could hope for would be 4.5 percent upon the stock.

Mr. VINSON. Approximately how much of this bonded indebtedness is actually represented by capital investment?

Mr. FLETCHER. You mean money put into the property? Oh, all of it, and more.

Mr. HILL. That is rather an interesting statement you just gave us there as to why the railroads have not reduced their funded indebtedness.

Mr. FLETCHER. It is a whole subject in itself, Mr. Hill, which I think is a very interesting one. I have an idea that if the railroads of this country were to be able, through some magic, to pay off all their funded indebtedness so that their outstanding capitalization would be reduced to the amount of the capital stock, what would happen to their rate structure? It might be a good thing to do in the interest of the investor. I am sure many of the men, at least, who own these bonds, would like to see it brought about if some Fortunate's purse could be discovered.

Mr. HILL. Rather, those who own the common stock would be more interested.

Mr. FLETCHER. They would be very happy, indeed, if the regulating authorities would reduce the whole body of railroad rates down to where it would amount to no more than 3 or 4 percent upon the value of the capital stock. That might be a good thing to do, except you would have to take into consideration what sacrifices have been made by the stockholders in order to accumulate the money to pay off these bonds. To ask this generation to make those sacrifices for the benefit of future generations is to attribute to them a sort of self-sacrificing altruism that is hardly in accord with human nature.

Mr. HILL. I had not expected, so far as I am concerned, to do that in a very short period of time, but I have often wondered why they have, apparently, never reduced their funded indebtedness.

Mr. FLETCHER. There are many reasons. One is the difficulty of getting money. Another is the inherent inadvisability of shrinking of their capital.

Mr. HILL. As it affects the rate structure?

Mr. FLETCHER. As it affects the rate structure. I am trying to be candid, Mr. Hill.

Mr. McCORMACK. In other words, they keep the bonded indebtedness to keep the rates up?

Mr. FLETCHER. That is one way to put it.

Mr. McCORMACK. That is rather a selfish viewpoint, is it not?

Mr. FLETCHER. I doubt if it is a selfish viewpoint, because they are entitled to a fair return upon the value of their property.

Mr. McCORMACK. But it is rather poor business not to make provision for the amortization of funded indebtedness.

Mr. FLETCHER. In the case of an ordinary industry, undoubtedly, but now we have to deal with people as we find them, with regulating authorities as we find them, and with human nature as we find it. We are entitled, under the Constitution, to a fair return upon the value of our property.

Mr. McCORMACK. I am not going to argue with you.

Mr. FLETCHER. I know you are not.

Mr. McCORMACK. I am not asking you any questions in a controversial sense.

Mr. FLETCHER. Here is what would happen, Mr. McCORMACK: That constitutional guaranty would be of no value if you actually had a situation where the capital structure of the railroads was reduced by two-thirds; you might argue until you were black in the face with the average rate-regulating authority that you were entitled to a fair return upon the value of the property, and they would say, "Oh, but you are paying 10-percent dividends. We cannot let you pay that."

Mr. McCORMACK. I know, but the failure to set aside reserves in the past brings up this question:

You are confronted with the fact that new inventions have brought about new methods of competition. What about these investors of the past? What are they going to do when competition reduces the value of the property?

Mr. FLETCHER. If competition reduces the value of the property to the point where much of the property is obsolete and no longer needed in the public service, I suppose they will just have to readjust themselves to a certain amount of loss.

Mr. McCORMACK. But in bygone years those losses could have been anticipated, perhaps, if they had set aside a proper reserve for the payment of their funded indebtedness.

Mr. FLETCHER. They could, Mr. McCORMACK, if those who fixed the charges of the railroads could have gone along with them sympathetically in such a program.

Mr. McCORMACK. While this is a lot of water over the dam in a sense, still it is very interesting; but I do not think you want to leave it in the record that you are going to place the whole blame on the Interstate Commerce Commission.

Mr. FLETCHER. Not the whole blame.

Mr. McCORMACK. The railroads will take a little blame!

Mr. FLETCHER. Oh, they are not perfect.

Mr. McCORMACK. There are abuses!

Mr. FLETCHER. Yes; there are abuses in any large industry, I suppose, but I would not think that the failure to set up reserves to retire their bonds should be classified as an abuse. That is too strong a term.

Mr. McCORMACK. As what could you classify it?

Mr. FLETCHER. It might be possible, more than anything else, I feel, through the development of invention,

Mr. McCORMACK. Certainly. It is not looking into the future, as we view it, with a reasonable and proper business vision.

Mr. FLETCHER. It would be a policy which would hardly call for criticism if traffic had not gone to the highways.

Mr. McCORMACK. The traffic would not have gone to the highways if there were no new inventions.

Mr. FLETCHER. That is true, but to expect them to anticipate the invention of the gasoline engine and its application to transportation on the highways is a good deal to expect of anybody.

Mr. McCORMACK. I know, but they had the experience of the railroads superseding some other modes of transportation, did they not?

Mr. FLETCHER. They superseded the water lines, if you mean that, and the stagecoaches, if you mean that.

Mr. McCORMACK. Well, I will not continue that line of questioning.

Mr. FLETCHER. It is a question. It may be that they should have been sufficiently astute. I heard the senior member of the Interstate Commerce Commission making a very interesting little speech down here at a luncheon the other day, in which he said that all these railroads and all the steamboats and all these motor trucks had better be getting ready to lose all their traffic to the air in 25 years from now.

Maybe they will, but I do not know how they could go ahead and base their financing and their whole arrangements upon such an idea. Maybe they will.

Mr. VINSON. If you take the industry today with its bonded indebtedness and with the companies' operating deficits, as our colleague from Pennsylvania, Mr. Rich, would say, "Where are you going to get the money?" to pay off this bonded indebtedness?

Mr. FLETCHER. Mr. VINSON, that is an individual matter with each railroad, is it not? After all, while we speak of the railroad industry, you cannot ignore the characteristics and the situation of each individual railroad.

I should not think that would be a matter of much concern to some railroads. There are a few who can view the future with complacency in that respect. But if a railroad cannot pay off its bonded indebtedness, it just has to take the same course that any other line of business or that you and I would have to take, and take recourse in the bankruptcy courts.

Mr. VINSON. The point I was making was in regard to setting up a sinking fund to amortize this indebtedness. If they are operating in the red, there is just no money coming in to permit them to do it.

Mr. FLETCHER. That is true.

Mr. VINSON. Whether it be a good thing or not.

Mr. FLETCHER. That is obviously true, Mr. VINSON, and that has been true, unfortunately, for some time.

Mr. HILL, may I ask you, is it the purpose of the committee to hear me further, or would you rather I would come back?

Mr. HILL. We will hear you further at this time. You have been interrupted here so much that we would like to know just what your recommendations are.

Mr. FLETCHER. Yes; I am just getting to that.

With your permission, I will file with the committee a two-page statement of what those recommendations are.

Mr. HILL. You may have that permission.

(The statement referred to follows:)

PROVISIONS REQUESTED BY RAILROADS FOR INCORPORATION IN ANY LAW THAT MAY BE ENACTED FOR THE TAXATION OF UNDISTRIBUTED CORPORATE EARNINGS

A

It is recommended that railroads be permitted, in arriving at "undistributed net income", to deduct from "adjusted net income", in addition to the other deductions mentioned in recommendation II of the subcommittee's report, the following items:

(1) Amounts applied to sinking and other reserve funds under mortgages, deeds of trust, or other contracts, or paid or reserved to retire funded debt, issued or assumed, but not to exceed 1 percent of total funded-debt obligations issued or assumed and outstanding at the end of the taxable year.

(2) Amounts paid to the United States of America or any corporation or other agency thereof in the reduction of loans made to or assumed by the taxpayer.

(3) Expenditures chargeable to capital account made pursuant to requirements by or agreements with Federal, State, or other public authority.

(4) Amounts provided for by reorganization plans to be invested in additions and betterments before the payment of interest on bonds issued pursuant to said plans.

B

It is further recommended that railroads, in arriving at "adjusted net income", be permitted to deduct allowances for depreciation and losses on retirement of property as provided hereunder:

(a) Where property, including equipment, is being operated under an agreement with the owner thereof, the lessee shall be entitled to deduct a reasonable allowance for the exhaustion, wear and tear, and obsolescence of such property, unless by contract the lessee is obligated to pay to the lessor such an amount as additional rental, in which event the lessor shall be entitled to make such deduction.

(b) The amount of losses incident to the retirement of leased property, including equipment, as permitted under regulations prescribed by the Interstate Commerce Commission, shall be allowed as a deduction from the gross income of the lessor or lessee, as contracts may provide.

Mr. FLETCHER. The first recommendation I want to make in that connection grows out of the very fact that whatever may have been the mistakes of the past, in the state the industry is in at the present time there is the utmost necessity for the railroads to be permitted to create sinking funds in order that their funded debt may be in a measure amortized.

That grows out not only of considerations which have been hinted at by members of the committee, but out of the fact that there is an increasing number of contracts into which the railroads are entering which require them to set up sinking funds.

I mean by that that very often when railroads' debts are refunded under the direction of the Interstate Commerce Commission or perhaps under the urge of the necessity of doing so in order to sell the securities, those contracts provide for sinking funds to be set up and maintained regularly for the retirement of the bonds.

There are a few bond issues which have been some time in existence where those requirements are found.

The Interstate Commerce Commission is increasingly following the policy of requiring railroads when they refund their indebtedness or issue new securities to set up sinking funds. It seems to

me that unquestionably it would be desirable in the light of the peculiar character of this industry to allow sinking funds to be created, and for that reason we venture to make the suggestion that the railroads be permitted in arriving at their undistributed net income to deduct from the adjusted net income, as the term is used in the printed plan, in addition to the other deductions mentioned in the second part—part II—amounts applied to sinking and other reserve funds under mortgages, deeds of trust, or other contracts, or paid or reserved to the retirement of funded debt, issued or assumed, but not to exceed 1 percent of total funded debt obligations issued or assumed and outstanding at the end of the taxable year.

That is the first of the recommendations.

Mr. HILL. That will take you a hundred years to pay it off.

Mr. FLETCHER. That is assumed. We would like to have more, but I do not think the committee would permit it. We thought the committee would hardly look with favor upon a greater amount than that 1 percent. That would help a great deal.

Mr. COOPER. Will you please read it again, if you do not mind?

Mr. FLETCHER. Our idea was that in addition to the amounts which may be deducted as stated in part II of the plan, the railroads be permitted to deduct amounts applied to sinking and other reserve funds under mortgages, deeds of trusts, or other contracts, or paid, or reserved to retire funded debt, issued, or assumed, but not to exceed 1 percent of total funded debt obligations issued, or assumed and outstanding at the end of the taxable year.

Mr. VINSON. It is your thought that that would be exempt from payment of any tax?

Mr. FLETCHER. It would be exempt from payment of any tax if you would repeal the income tax, excess-profits tax, and the capital-stock tax.

Mr. VINSON. That is what I had in mind.

Mr. FLETCHER. I had an alternative proposition to make, if I think my time permits on this subject, that would answer the implied objection which is involved in your question, Mr. Vinson.

Mr. VINSON. I was assuming that the railroads were coming under the plan proposed.

Mr. FLETCHER. That is the assumption, yes; that underlies this suggestion.

Mr. VINSON. I thought that because of paying 1 percent, that modest sum, probably that was to be exempted from taxes.

Mr. FLETCHER. As I see it, if it comes under the plan at all,

My second suggestion relates to another class of obligations which the railroads have, and that is, amounts which have been borrowed from lending Government agencies, that is, the Reconstruction Finance Corporation, and practically covers the whole field in that respect.

The railroads owe the Reconstruction Finance Corporation, as I recall, about \$400,000,000. They owe the Public Works Administration about \$200,000,000 and unless my information is incorrect, the Public Works Administration has sold to the Reconstruction Finance Corporation practically all of the notes of the railroads covering that \$200,000,000. So that the indebtedness to the Reconstruction Finance Corporation, I suppose, runs pretty close to \$600,000,000.

These are short-time obligations. They are obligations owing to the Government. They are amply secured, and by reason of the extreme caution which has been used by the Interstate Commerce Commission and the Reconstruction Finance Corporation, they have tied up and rendered unavailable for ordinary purposes enormous amounts of collateral.

When the railroads undertook to secure this money from the Reconstruction Finance Corporation, they were required by the Interstate Commerce Commission to put up sound collateral at the then market price, and the market price was very low in those days when most of those loans were executed, so that the railroads are enormously embarrassed by reason of the withdrawal of that collateral from ordinary use.

Our suggestion is here, not to labor the point, in view of the fact that the indebtedness is owing to the Government, that amounts which are paid to the United States Government or any lending agency of the Government, should be put in the same class as this 1 percent which I have already discussed.

Mr. McCORMACK. Judge, let me see if I understand you correctly. You do not mean to say that that 1 percent of the funded debt—which is over 10 billion dollars, or over \$100,000,000—should be exempt from all taxation?

Mr. FLETCHER. I did not mean to say that you should just make a rule that would exempt 1 percent, but that you should exempt the amount set aside for sinking funds not in excess of 1 percent of the total bonded indebtedness.

Mr. McCORMACK. But you would want that subject to the flat tax, would you not?

Mr. FLETCHER. My suggestion here was that if we could, under this law at all, it should be treated just as other deductions from taxable income and not taxed at all.

Mr. McCORMACK. We would be giving you something we would not be giving to any other corporation, would we not?

Mr. FLETCHER. You would be giving us something that other corporations under this plan would not get; I think that is so.

Mr. McCORMACK. I think, without regard to the past history of the railroads—and I do not think it is all bad—they justify exceptional treatment in some respects.

Mr. FLETCHER. The exceptional treatment is accorded here, Mr. McCORMACK, to the insurance companies, for instance, and I can well understand why that is done; they hold trust funds largely. The 15-percent flat tax would be very satisfactory to the railroads; I should say that.

Mr. VINSON. But in regard to other corporations, Judge, where they have obligations that are secured by lien upon their property expressed in mortgages, and a prohibition against the declaration of dividends, on that character of income for those corporations we have recommended to the full committee a flat rate of 22.5 percent.

Mr. FLETCHER. Yes; I remember that.

Mr. VINSON. I just do not quite get the thought that moneys earned by the railroads to be applied for the same express purpose should be tax exempt.

Mr. FLETCHER. It would not be tax exempt if you were to put the railroads on the same basis as the insurance companies.

Mr. VINSON. No. They would not be under the general plan.

Mr. FLETCHER. They would not be under the general plan, that is true.

Mr. VINSON. But let us assume that you would go under the general plan, and then take this class rate, for certain moneys used to pay indebtedness under contract, not to declare a dividend; do you not think that you ought to be in substantially the same class with other corporations?

Mr. FLETCHER. I would find great difficulty in giving any reason why they should not, Mr. VINSON, but that does not mean that I think the thing is entirely fair to other corporations.

Mr. VINSON. I understand that.

Mr. FLETCHER. It is not my province to argue their cause, however. But it does seem to me where you prevent by contract the payment of dividends, then to tax them as high as 22 percent for not doing something that their contracts prohibit does seem to be not quite "cricket."

Mr. VINSON. That deals with the question of the reasonableness of the rate?

Mr. FLETCHER. Oh, yes.

Mr. VINSON. That is the point you have in mind.

Mr. FLETCHER. I think it is too high.

Mr. VINSON. That is the point you have in mind?

Mr. FLETCHER. Yes.

Mr. VINSON. I think I could go farther and say that where it is a question of capital investment required to be made, or the payment of debts required to be made, in the absence of this prohibition against the declaration of dividends, there might be much that could be said in respect of this preferred rate. I take it you would agree to that?

Mr. FLETCHER. I would not argue adversely to that contention.

Mr. VINSON. You say 22.5 percent is a little high. What rate would you think would be fair?

Mr. FLETCHER. I do not think 15 percent is a bad rate.

Mr. VINSON. What are you paying now?

Mr. FLETCHER. 15.75 for income tax, plus the capital stock tax.

Mr. COOPER. You pay 2 percent, do you not, Judge, for the consolidated return?

Mr. VINSON. No; not any more.

Mr. FLETCHER. Yes; we do, Mr. VINSON. We had quite an argument about that before, did we not? You were right that time but I believe I am right this time. We do pay 2 percent.

Mr. VINSON. You are paying three-fourths of 1 percent above the 15 percent?

Mr. FLETCHER. Yes.

Mr. VINSON. I am still right.

Mr. FLETCHER. All right. I thought ordinary corporations paid 13.75 percent.

Mr. VINSON. No. The rate graduates, Judge, from 12.5 to 15 percent, and the 15-percent rate applies where the net income exceeds \$40,000. So what you are paying really is a premium of about three-fourths of 1 percent for the privilege of filing the consolidated return.

Mr. FLETCHER. I guess I am wrong again, Mr. Vinson.

Mr. McCORMICK. On top of that, you pay your capital-stock tax.

Mr. FLETCHER. We pay a capital-stock tax.

Mr. McCORMICK. \$1.40 a thousand?

Mr. FLETCHER. That is right; \$1.40 a thousand. That is cut down to 70 cents a thousand under this plan.

Now I must hurry on. The third suggestion we make—

Mr. VINSON. Before you get there, Judge, we are interested in this because this is a serious proposition.

Mr. FLETCHER. I am sorry I cannot be more helpful.

Mr. VINSON. We may have to bring you back. But I would like to get your views as to the approximate average rate of income tax, capital-stock tax, and excess-profits tax paid by the railroads.

Mr. FLETCHER. Of course, the railroads pay a substantial amount in capital-stock tax. The railroads that have a taxable income, if I may use that term, or adjusted income, pay, of course, the 15.75 percent provided for making a consolidated return. The excess-profits tax, of course, as you may well imagine, in the case of railroads has been very small.

Mr. VINSON. Could you supply for the record what the average rate is, including the corporate rate, capital-stock tax, and excess-profits tax, as paid by the railroads having a net income?

Mr. FLETCHER. I think I can do that.

Mr. HILL. That is in percentage of the income?

Mr. VINSON. Yes. That is as to those paying net income, because if you would take deficits in there it would be something else.

Mr. FLETCHER. I think I can do that in the next few days.

Mr. VINSON. That would be very helpful.

Mr. COOPER. Would you be prepared to give us an idea as to that now, Judge, subject to correction?

Mr. FLETCHER. It would have to be a pretty rough one, Mr. Cooper. I have an idea that the income tax—you mean now in amount paid by the railroads for income tax?

Mr. VINSON. The percentage; yes.

Mr. HILL. The percentage of the income.

Mr. FLETCHER. The percentage of the income?

Mr. HILL. That is, give the percentage these total taxes are of the net income.

Mr. FLETCHER. Of all the railroads of the country?

Mr. VINSON. No; of those having a net income.

Mr. FLETCHER. No, sir; I could not do that; I am sorry. I do not have the information.

Mr. VINSON. You have to reduce the capital-stock tax to percent.

Mr. FLETCHER. That is right. It is a little too intricate for me to answer offhand, but I will be very glad to have our experts prepare that and file it in the next 2 or 3 days with the committee.

The third thing I want to speak about in that connection as, we think, entitled to deduction, is the amounts which are spent by the railroads for nonproductive improvements in their property forced by public authority. I have in mind there the necessity of constructing passenger stations like the one in Los Angeles which the railroads were compelled to construct under order of the authorities.

It would apply also to very considerable amounts spent in paying along their rights-of-way in many of the municipalities. It would apply to a very large extent on those expenditures for grade crossing elimination, a burden which Congress is doing a good deal to relieve the railroads of. I am very glad to say.

The fourth of those which I have in mind is one which is a little bit peculiar and grows out of the fact that, as I said a little while ago, unfortunately 28 percent of the railroad mileage of the country is in the hands of the court undergoing reorganization under section 77 of the bankruptcy law.

There is a growing tendency on the part of courts to require railroads, after they emerge from one of these reorganization proceedings, to expend a certain amount of money in additions and betterments to the property before they are permitted to pay the interest upon a number of the income bonds which are issued in the plan in process of reorganization.

Mr. HILL. Under that suggestion, you would have a deduction for 100 percent of the cost of replacing the switch stand as to which you gave an illustration a while ago.

Mr. FLETCHER. No, we would not, Mr. Hill. I put that in there only to try to convince the committee of the extraordinary peculiarities of the railroads brought about by the idiosyncracies of their accounting system under the directions of the Interstate Commerce Commission. They would not apply there. I am talking about my third suggestion, where some public authority requires you to do something for the convenience of the public or to add to the ornamental features of the landscape, as they often do in the case of railroads, and it has no effect whatever in increasing the railroads' income.

I know I cannot keep you here, and I would like to have the privilege, which was offered me by the chairman, of filing a supplementary statement.

Mr. HILL. How much longer would it take you to finish your statement?

Mr. FLETCHER. Oh, I think I had better quit, Mr. Hill. I try to be considerate about these things.

Mr. HILL. You will submit for the record a written statement?

Mr. FLETCHER. A written statement of the other points I want to mention, I will file in the record.

The CHAIRMAN. Without objection, they will all be inserted in the record.

Mr. FLETCHER. We have some suggestions here on the very important question of depreciation as applied to this new bill. They are not an exact repetition but along the lines of some arguments which I ventured to make to the committee once before as to the injustice which is now imposed upon the railroads in not allowing them to take into consideration the depreciation upon their leased equipment. That I will content myself under the generous offer of the Chair with filing as a part of my remarks.

Mr. HILL. You may have that permission, Judge Fletcher.

I want to thank you, Judge, for your contribution.

(The statement submitted by Mr. Fletcher follows:)

It is recommended that railroads, in arriving at adjusted net income, be permitted to deduct allowances for depreciation and losses on retirement of property as provided hereunder:

(a) Where property, including equipment, is being operated under an agreement with the owner thereof, the lessee shall be entitled to deduct a reasonable allowance for the exhaustion, wear and tear, and obsolescence of such property, unless by contract the lessee is obligated to pay to the lessor such an amount as additional rental, in which event the lessor shall be entitled to make such deduction.

(b) The amount of losses incident to the retirement of leased property, including equipment, as permitted under regulations prescribed by the Interstate Commerce Commission, shall be allowed as a deduction from the gross income of the lessor or lessee, as contracts may provide.

Railroads have been accruing depreciation on rolling stock since 1907. Extensive studies, both from an engineering and an accounting viewpoint, have been made, and the Interstate Commerce Commission has by orders recently fixed the rates of depreciation so that in no event will railroads be permitted or required to charge excessive sums for depreciation. Class I railroads' investment in road and equipment, exclusive of land, was approximately \$23,000,000,000 at the end of 1934, while for this year the aggregate of their charges for depreciation was but \$187,000,000, or less than 1 percent of such investment.

To promote economy and efficiency of operations of the railroads in the public interest, the operations of two or more railroads have, in many instances, been combined to form one system. Since the passage of the Transportation Act of 1920 these leases have been approved by the Interstate Commerce Commission and generally follow the mandate of that act in promoting consolidations therein provided for. Under the rules of the Interstate Commerce Commission the lessee must include in its accounts all expenses, including depreciation, with respect to the leased properties as part of its cost of doing business and such expenses should properly be deducted from gross income in computing adjusted net income.

The CHAIRMAN. I want to see if we cannot get through early tomorrow. We will have half a dozen or so witnesses. The committee will adjourn now, and, if agreeable, will convene at 9:30 a. m.

(Whereupon, at 5:40 p. m., the committee adjourned until 9:30 o'clock a. m. Apr. 4, 1936.)

April 4, 1936

The Secretary

Mr. Lochhead

It seems probable that aside from a general discussion of China's economic and monetary problems the principal objective of K. P. Chen's coming visit is to arrange for the disposal of additional silver to the United States on terms which would be advantageous to China.

In considering any such proposals it would seem to be the duty of the Treasury to endeavor, without taking advantage of China's situation, to see that the transactions suggested were mutually advantageous and in accordance with the general principles of the silver policy of the United States.

Since going on a managed currency basis China has never definitely stated whether her currency would be linked to gold, silver, the pound sterling, Japanese yen, or United States dollar. Some vague references have been made by Kung that he is partial to the use of silver as a monetary reserve, or in subsidiary coinage, but no assurance has been given as to the extent silver will actually play in their final currency program. There is no doubt, however, that at the time China went on a managed currency basis she was willing to sell all the silver in the monetary system under her control, which procedure probably had the approval of Leith Ross, with the possibility that such a plan may have been originally suggested by him. Therefore, the United States Treasury, in all probability, will again be requested to purchase silver, as the Chinese continually point out the necessity for increasing the size of their stabilization fund, and as they apparently cannot obtain a loan for this purpose from England, the utilization of their silver is the only means they have of obtaining foreign exchange to bolster their stabilization fund.

The following are three methods by which the Chinese may be able to utilize the silver in their monetary system to obtain foreign funds:

(1) By an outright sale of silver to the United States either at the market price, or if possible, at a premium over the market price. If the Treasury consented to such a purchase without a definite undertaking from China to maintain silver at least as a partial basis of her monetary reserve it might well be held that we had actually damaged the cause of silver by encouraging and assisting the largest silver using country of

the world to desert the use of silver as a monetary basis. If China agreed to maintain silver in her monetary system in at least the same proportion as that maintained by the United States, i.e. 25%, the United States might undertake to purchase the excess over this proportion in order to provide China with funds to maintain the value of her currency in foreign markets. It is doubtful that China would be prepared to make any such agreement at the present time and any unofficial understanding of this nature might very easily be broken at some future time under the excuse of stress of circumstances.

(2) The United States might agree to make a loan to China against silver at around present prices, the loan to be liquidated by the sale of the silver in case of need. Such a loan may very easily turn out to be nothing more than a direct purchase of silver as it could provide China with an excuse for disposing of the silver by pleading lack of funds to repay the loan. In the case of a loan there would arise the question as to whether or not participation in such a loan would have to be offered to the other members of the Chinese consortium.

(3) A third method would be an agreement by the U. S. Treasury to purchase yuan from China in exchange for dollars up to some fixed limit whenever China was in need of foreign exchange. China would simultaneously agree to repurchase these yuan at the same rate for forward delivery and as security for the fulfillment of these exchange contracts an equivalent amount of silver at current rates would be furnished by China as collateral. Upon a demand being made on China by the United States for the repurchase of the yuan the Chinese would either have to furnish the dollar equivalent or authorize the United States to sell sufficient silver in order to make up any loss on the sale of the yuan. In this manner assistance could be given to China on the basis of currency stabilization rather than through the purchase of silver. An important feature of this transaction is that it would compel China to retain a direct interest in silver due to the fact that if it was necessary to sell any of their silver collateral at a loss, owing to a decline in the price of silver, such loss would be borne by them.

April 4, 1936.

Respectfully P. L. and To
Commissioner of Customs
Division of Customs Agents

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E. H. Jacobs
Ta U. S. TREASURY ATTACHE
NANKING, CHINA.



A GENERAL SURVEY OF THE LATEST POLITICAL
SITUATION IN NANKING

MAY-2'36PM

In the past month, Nanking witnessed a lull in its political atmosphere, internally and externally. The long talked about Nanking-Canton rapprochement and the outstanding Sino-Japanese issue saw very little development. Although considerable negotiations are still going on concerning these two important cases, it affords very little hope of any marked progress in the near future. However, in a recent survey made by your agent, some very important facts have been secured from authoritative sources and are outlined in the following. These facts, it is believed, will play not an insignificant role in shaping China's future in time to come.

The Chiang-Arita Conference

One of the most important affairs of the past month is the conference held in Nanking between General Chiang Kai-shek and Mr. Arita, until recently Japan's Ambassador to China. While the contents of their talk have been kept in absolute secrecy, it was learned from reliable circles, both among Chinese and Japanese officials, that their talk did not make any concrete headway in the improvement of Sino-Japanese relations. Mr. Arita has been heard to have remarked to his Japanese colleagues after the conference with Chiang, that he had a very poor impression of the generalissimo. In his opinion, he thinks Chiang is very crafty and insincere towards Japan. He urged

that Japan should adopt a stronger policy towards Nanking.

On the part of General Chiang, he has found the new Japanese ambassador's demands impossible to accept. With Mr. Hirota's famous three point policy as the basic principle, Mr. Arita wanted an independent regime for North China entirely separate from Nanking economically, financially and politically. He wanted it not only in fact but also in name. If Chiang should accept such a proposal, he will have to rank himself as traitor number one in the eyes of the whole world. This he cannot do, for he does not want to "lose face." As General Chiang is not ready and courageous enough to take up an armed resistance against Japan, such negotiations will probably be shifted from Nanking to North China, where the local authorities such as General Sung Cheh-yuan and General Chin Teh-shun will be authorized to carry on and find a formula to satisfy the Japanese. In this way, General Chiang will not have to face the responsibility.

North China Leaders and Nanking

The real attitude of the North China leaders such as General Sung Cheh-yuan, General Chin Teh-shun, General Han Fu-chu and others towards Japan could be best illustrated with a recent statement made by General Isogai (), until recently Japanese military attache in China, who remarked that after his trip to North China, he was terribly disappointed with the state of affairs there. The Chinese leaders there are still running North China according to the wishes of Nanking Government. He believed that strong penalizing measures should be applied to such men as General Sung Cheh-yuan, who owe their phenomenal rise to

the backing of Japan's military. The real situation is that these men, although anti-Chiang Kai-shek, still listen to their leader General Feng Yu-hsiang who is now cooperating with the Nanking group. They are maintaining friendly relations with the Japanese military there primarily to preserve their own strength and position. In case Nanking adopts a real anti-Japanese attitude, they are quite ready to fight for the nation. But if Nanking continues the weak-kneed policy, they see no reason why they could not "sell out" to the Japanese themselves instead of waiting to be "sold".

The North China leaders have in recent months maintained a close contact with Mr. Hu Han-min and the Cantonese clique. Both parties exchanged envoys. It seems that they have found at least one thing in common, a "disapproval of General Chiang's foreign policy." It is believed that if the Nanking-Canton rapprochement does not succeed soon, the North China leaders will join hands with the South in a strong denunciation of Nanking.

Recent Sino-Japanese Disputes

In viewing several cases of Sino-Japanese disputes one can easily tell that the Nanking authorities are still maintaining a very weak policy towards Japan, in spite of all sorts of propaganda for a "holy war".

(1) Japan has made no reply to Nanking's repeated protest against illegal and unauthorized flights of Japanese military planes in North China. Japanese planes continued to fly in total disregard of Nanking's protests. Nanking remains inactive and has not carried

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out the threatened measures to check these illegal flights.

(2) In spite of Japan's assurance to help check smuggling of Japanese goods in North China, smuggling continues under Japanese auspices on an even larger scale in the past two weeks since the Sino-Japanese understanding. Nanking has done nothing to remedy the situation for fear of further Japanese entanglements.

(3) A Japanese spy was arrested in Kiangsi recently for conducting espionage work among the Chinese army. As soon as the Japanese learned of the arrest, two gun-boats were sent there and several unreasonable demands were presented to the Chinese authorities. These demands requiring immediate release of the spy, apology by Chinese authorities, etc. etc. The Japanese further stated that unless all these demands are fully carried out, Japanese marines will land in Amoy and take possession of the island within 24 hours. The Chinese authorities, after consulting General Chiang, accepted all the Japanese demands and closed the case.

(4) Drastic measures have been applied by Chinese authorities in Peiping and Shanghai, according to the instructions of General Chiang, to suppress student movements in these two cities. Student societies have been dissolved, leaders arrested, active students expelled from their colleges, and in many cases some teachers who are sympathetic towards the patriotic movements have also been charged with being communists. In Shanghai over twenty progressive magazines which published anti-Japanese literature have also been suspended and their editors arrested. All these steps are taken simply to satisfy Japanese wishes.

The Canton-Nanking Rapprochement.

According to latest information from a reliable source, the prospect for the long-talked of Nanking-Canton rapprochement will not be an immediate success. The officials around General Chiang Kai-shek do not want it to be realized for fear their interest will be affected. In case the cooperation is successful, General Chiang simply has to withdraw his men from several ministries so as to make room to place some of Mr. Hu Han-min's men in the government. This situation is what General Chiang's men are gravely concerned about. For this reason they are doing everything to prevent the rapprochement from materializing.

On the other hand, Mr. Hu Han-min's subordinates do not want to see their leader in cooperation with General Chiang except in patriotic principles without political conditions. They want to make General Chiang promise definitely to vacate several government ministries for their men to occupy. For this reason, they likewise want to hold up the "rapprochement scheme" until such a bargain is actually transacted.

In the light of the foregoing information, we can easily imagine that the rapprochement between Nanking and Canton will be still a remote affair. General Chiang Kai-shek's attitude could be seen with the fact that as soon as Dr. Wang Chung-hui, until recently Chinese jurist at the Hague Court, arrived in Shanghai on behalf of the South, he left hurriedly for Fenghua. That showed he was reluctant to see the southern envoy. As the whole nation attached

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great hope on Dr. Wang's visit, he found the situation caused by General Chiang's absence from Nanking most embarrassing. He therefore had to enter the Country Hospital under the pretense of being sick in order to save his face and also to more conveniently watch developments. Now General Chiang had officially requested Dr. Wang to come to Nanking on April 1st to talk over the situation. But the result has been found to be very vague. Well-informed circles in Nanking believe that General Chiang will play with Canton until after he is elected the First Constitutional President of the Chinese National Government this winter, then he will negotiate with the South. At that time he will be in a stronger and more favorable position than as at present. He does not wish to permit Mr. Hu Han-min the opportunity of competing with him in the forthcoming presidential election. Hu will stand a better chance than Chiang, if given the same opportunity.

The activities of Mr. Hu Han-min's group and that of the anti-Japanese group will be reported in a separate memorandum.

April 7, 1936

Respectfully Referred To
Commissioner of Customs

Division of Customs

For
E. C. Jackson
U. S. ATTACHE
NANKING, CHINA.

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MAY - 2 '36 PM

NANKING'S POSITION WITH U.S.S.R. AND
JAPAN

As it was pointed out in several memorandums previously submitted, Nanking is making preparations for a possible war with Japan in case all channels for peace negotiations are closed. In citing some of the facts in this connection, it is not meant that Gen. Chiang Kai-shek and his colleagues are firmly determined to put up armed resistance against further Japanese aggressions or are they really waiting for a definite time to strike the right blow. They are, as they always declared, waiting to be fully armed, for they do not want to take chances in this war with Japan whose military equipment is far ahead of China. Of course, this may be true, but this also shows their lack of courage and their preference for the easier task of seeking a compromise with Japan. Another aspect of the situation is such that these war preparations have more than once been utilized by Gen. Chiang as tactics to defeat his political enemies in times of emergency such as during the Kuomintang Conferences last November, and in winning Gen. Feng Yuxiang and Gen. Yen Hsi-shan to participate in Central Government affairs.

Whatever political motives may be behind these war preparations, this report is an attempt to bring some relative facts of the subject to your attention. They are believed well worthy of interest.

Great importance is attached to Gen. Chiang Po-li's (蔣百里) present trip to Europe on behalf of the Nanking Government. Ostensibly, he is taking an inspection trip in a semi-official capacity, but in reality he is on a secret mission entrusted by Gen. Chiang Kai-shek to

make important military arrangements with several European powers. Gen. Chiang Po-li is considered one of China's outstanding war experts and is generally looked upon as the best mind in war planning. In the past three years he has openly lived in Shanghai in retirement, but secretly, he serves as a high official of the Committee on National Defence in Nanking. He left Shanghai for Europe about two weeks ago without attracting much public attention. Just before his departure he was asked by Gen. Chiang to be back in China within six months, for China will need his services badly by that time. This was interpreted by people close to him as a hint of a possible war with Japan at that time. No one knows just how he is going to perform his duties, but it has been learned from reliable sources that much political and military significance is attached to his trip abroad.

China's inclination towards an alliance with U.S.S.R. for a possible concerted action against Japan can be seen in some recent facts as outlined below:

(1) The Central Propaganda Committee of the Kuomintang Headquarters recently issued a secret order to all the local press censorship committees through out the country to discontinue withdrawing pro-Soviet articles from magazines and daily papers. As a result, news items of publicity for military supremacy, good administration, social, industrial and economic success of the Soviet Union appear in various papers in considerable numbers.

(2) Gen. Li Tu (李杜), the famed anti-Japanese hero of North Manchuria, who is living in retirement in Shanghai, has been heavily subsidized by Gen. Chiang Kai-shek to carry on private negotiations with the Soviet authorities on behalf of Nanking. Gen. Li withdrew his forces to Siberia and then entered Sinkiang through the help of the

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Soviet after his defeat by over-whelming Japanese forces. His forces numbering at least 15,000 are now in Sinkiang and are all well-trained and equipped under expert Russian direction. The entire Chinese force in Sinkiang numbers about 100,000. It is reported that Nanking has secretly subsidized these armies, which are under Russian training, and prepared to operate against Japan at the crucial moment. The Soviet Ambassador and his staff are in close and constant touch with Gen. Li Tu, who lives on Hwa Kee Avenue, Bubbling Well Road, Shanghai.

(3) Dr. W.W. Yen, China's Ambassador to Moscow is again on his way to Nanking. Well-informed circles in the capital believe that he is coming back for a very important mission, which undoubtedly is connected with China's proposed secret treaty with U.S.S.R. The only thing that hinders the cooperation of these two nations is the question of communist activity in this country. It is said that the Soviet has now agreed to cease supporting any such activities in China and that other factors are all agreeable.

(4) An unconfirmed report current in Japanese circles here indicated that Mr. Chen Li-fu (陳立夫), important Kuomintang leader and head of the Blue-Shirts Society, left secretly for Moscow sometime last month to conduct important negotiations with U.S.S.R. regarding a Sino-Russian alliance against Japan. Since this news was published in some local Japanese papers, a denial appeared in the Chinese dailies to the effect that Mr. Chen has been recuperating in a certain mountain resort in Chekiang and that he will not be able to return to Nanking until after two months. This makes the situation even more puzzling. It is believed the report is not altogether groundless.

(5) There is a movement among the Northern generals such as

Sung Cheh-yuan, Han Fu-chu and others to urge General Chiang to send Gen. Feng Yu-hsiang to North China to take charge of the situation. Most of these generals are Gen. Feng's former subordinates and are quite prepared to take his orders. Gen. Chiang Kai-shek is still hesitating because he thinks if this step is taken the Japanese will feel annoyed, for Feng has always been an anti-Japanese leader and his presence in North China will naturally arouse considerable enthusiasm among soldiers and the younger generation.

One thing quite certain about the Japanese is that they are ready to create another incident in North China similar to that of Manchuria on Sept. 18th, 1931. The Autonomy Government for Inner Mongolia will be realized in the near future. Mr. Arita, new Foreign Minister of Japan is now urging a Sino-Japanese Anti-Communist pact, which although appears to be rather vague, is, in reality, more serious than the three point policy advocated by Mr. K. Kirota, former Foreign Minister who is now the premier. It will not be long before Nanking will have to choose between "surrender" or "resistance."

April 8, 1938

HM, Jr. was back at his desk today, having returned yesterday from his vacation at Sea Island, Georgia. He conducted the usual 9:30 group meeting.

He told Gaston and Upham that he would like to collect the various speeches which have been made by critics of the Administration on its financing policies. He mentioned in particular Mr. Hoover, Sloane of General Motors, and Senators Borah and Vandenburg, and cited, as the best example he could give, the speech made by Senator Borah wherein that gentleman had said he was for sound money and to which an answer was made by the New York Times in a very good editorial. HM, Jr. wants answers to these attacks prepared and on hand for reference purposes; he said he did not want to wait until the heat of the campaign and then be rushed to get the material ready.

Gaston gave the Secretary the draft of a proposed Treasury Department press release which had been suggested by the State Department. It concerned the visit of the three Chinese bankers, K. P. Chen, Y. C. Koo and P. W. Kuo who are in this country for conferences with the Secretary at his invitation. The draft contained this sentence: "The conversation which was held related to financial and monetary matters in general and, in particular, to possible readjustments in connection with outstanding obligations of the Chinese Government held by agencies of the United States Government." HM, Jr. objected strenuously. He said, "When I take up monetary stabilization with a country, I do not want to discuss with that country anything else. That is the only way that I can work it so that Hull will let me handle these financial matters without interference from the State Department and in this way I will not be treading on their toes. I want to make it very definitely clear that I will not discuss 'credits' with the Chinese. I will only discuss monetary stabilization."

It was agreed that the Treasury would not use the State Department's suggested press release.

HM, Jr. asked McReynolds to get from Harry Hopkins or Cornington Gill data along the following lines. He wants to know, as of March 1 or for as many months back as it is possible to get the information, how many people had jobs under the Federal relief program, by States; also, how many people in the States are on home relief or any other kind of relief; in other words, a statement of those on relief, within a State, classified according to

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the various recognized forms of relief. He said, "I want to follow this thing through to know whether the unemployment situation is getting better or worse." He said he realized it was a difficult job to get this information together and that these are the sort of figures that Harry Hopkins does not want to give out, but he would like to have a preliminary report by tomorrow morning.

HM, Jr. asked Mr. Bell if he knew how much Harry Hopkins and Tugwell are going to be able to get along on between now and July 1. Bell said he would get the figures for the Secretary.

He also asked Bell for a list of the important legislation now pending which calls for appropriations over and outside of the Budget and said he wants to work with Bell on the proposed bill on reduced borrowing power. The latter was recently submitted to the President in memorandum form.

HM, Jr. said he had read an article, either in TIME or FORTUNE, on Anselinger and his dealings with the Racing Commission during the past two years. He said the story had not given credit enough to the Treasury for its accomplishments and, in fact, presented a rather weak picture for the Treasury. He asked Gibbons to give him a report by Wednesday morning, bringing him up to date on what we have done with the Racing Commission.

Governor Myers and Taylor and Bell met with the Secretary to discuss the Farm Credit Administration's refinancing. A 10-20 year bond at 99½ was decided upon. Myers, while he was in the Secretary's office, checked this with Crosby in New York. (Crosby is assistant to Dunn, who is fiscal agent for the FCA. Copy of the conversation is attached.) HM, Jr. also checked it with Burgess, who approved the terms.

After Myers' conversation with Crosby was concluded, HM, Jr. said, "We will take a vote and let Myers know." The vote was one-half of them for 99½ and the other half voted for 99¼. Taylor called Myers and said since it was a 50-50 vote, to go ahead with the price of 99½. However, Burgess telephoned the Secretary, not knowing he had left the office, and I talked to him. Burgess said that since the vote was so close he felt it would be taking a chance to have the price at 99½ and said he had, therefore, changed his mind and would prefer 99¼. I

-3-

then telephoned to Taylor who, in turn, got in touch with Myers, but it was too late to change the price because the offer was already on the wire. Taylor telephoned Burgess and after their conversation was concluded he called me back and reported that he had convinced Burgess that there was nothing to worry about and said they had both agreed that 99½ would go over.

FCA today gave the following information to the press:

"Announcement was made by Governor Myers that \$185,000,000 of 4½ percent individual bonds of the Federal Land Banks will be called tomorrow, Tuesday, and it is contemplated that a new issue of \$180,000,000 of consolidated bonds of the Federal Land Banks will be offered to the public on April 8. The new consolidated bonds will bear 3% interest and will be callable in 10 years with a maturity of 20 years. The called bonds will be refunded with the proceeds from the sale of the new issue and with cash."

- - - - -

HM, Jr. today asked Dr. Viner to be here on Thursday to discuss countervailing duties because Viner has made extensive studies on this subject and considers himself an authority.

Monday
April 6, 1936

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Wm. I.
Myers: Hello, Crosby?

Crosby: Yes

M: We've checked all the way around and ninety-nine and a half looks safe from here.

C: Yes

M: Do you think you can do it?

C: Well, I want to go back in - you see I've been out of the room while they've been talking about this thing and I want to get the feeling - when they first started the older heads,- I mean by that, Sylvester Brown-Harriman and Griswold thought that ninety-nine and a half and the others said they would rather have a ninety-nine and a quarter but that they thought a ninety-nine and a half would go. And Walter Sargeant started around the circle to confirm that when we were in - when I left. But I'll check back and we'll go ninety-nine and a half if they all agree that it will go at that. If there seems to be some considerable doubt I may call you back again.

M: All right.

C: Yes

M: O. K.

C: All right.

April 3rd 1936

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THE CLOISTER
SEA ISLAND, GEORGIA

Objectives for the months of April and May
1936

and new legislation

1. Combine all expenditures within the budget.
2. Raise sufficient money from new taxes to offset the loss of revenue from the supreme court's decision on the three A's and to pay the bonus.
3. Keep in touch with the international monetary situation.
4. Personally handle the raising of new funds to finance the New Deal.

Monday
April 6, 1936

Operator: Senator Byrd is driving in from Winchester this morning and he hasn't reached the office yet.

HMjr: Will you leave word I called, please?

Operator: Yes, I will.

HMjr: Thank you.

(Long pause)

Senator
H.F. Byrd: How are you?

HMjr: Hello, Harry

B: I haven't heard from you for a long time.

HMjr: Well, you know, I've been sick?

B: Have you been sick? I knew you'd been away, I didn't know you had been sick.

HMjr: Yes, I've been sick.

B: How are you feeling now?

HMjr: I'm feeling pretty well - I don't feel as though I could go out and spray an orchard all day though.

B: (Laughter) Take good care of yourself.

HMjr: Yes - Harry, the reason I'm calling up - your man Brown, Brownwell, or whatever his name is, was down -

B: Brownlow?

HMjr: Brownlow

B: Yes

HMjr: - was down here talking to our people about this bill that we have to coordinate all of our police activities.

B: Yes

HMjr: And, as I understand it, he's very much interested and I believe that Doughton took it over to you.

B: Yes

HMjr: If you think well of it and if Brownwell thinks well of it - It's something which I think very highly of as a move in the right direction - consolidates five police agencies all into one. I think we could save money and I know we would be more efficient.

B: Yes

HMjr: And I want to let you know that I was personally -

B: Fine, Henry. I haven't had a chance to study it yet. It's before the House, you see, now - ?

HMjr: Yes, but as I understand it Doughton brought it over to you.

B: Yes, he brought it. Well, he - I think he wants it - to have me to look after it in the Senate after it passes the House.

HMjr: Yes, well, if you look at it and do think well of it, I would be glad to discuss it with you.

B: Fine, Henry. I'll get the bill and study it - I haven't had a chance yet -

HMjr: If you'll let me know - and I'd like to discuss anyway with you the work that you've got.

B: Oh, yes, I'm willing to do that.

HMjr: Because I've given it a lot of time and a lot of thought -

B: Yes

HMjr: And it's something we've got to do and I'd like to let you know that I'm very very interested.

B: As soon as we get our ideas a little further advanced I'll come up and see you about it.

HMjr: Well, if we could have lunch together and talk about it. Because, it's something which I know we can help and I want to let you know that we're going to put ourselves at your disposal.

B: especially like to have your advice. And just as soon as we get a little further on I'll give you a ring and we'll have lunch together.

HMjr:

Fine

B:

All right, Henry, take good care of yourself.

HMjr:

Thank you.

B:

Goodbye.

HEARINGS

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

ESTIMATES OF THE REVENUE

FOR FISCAL YEAR 1936

BY

NO. 1



UNITED STATES GOVERNMENT
WASHINGTON, D. C.

COMMITTEE PRINT—UNREVISED

Note.—This print is for the immediate use of the committee
and is subject to correction

E. W. G. HUFFMAN, Clerk.

REVENUE ACT, 1936

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

SEVENTY-FOURTH CONGRESS

SECOND SESSION

APRIL 6, 1936

No. 7

Mr. Huplant
Mr. Hunt



UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1936

58540

REVENUE ACT, 1936

HEARINGS

COMMITTEE ON WAYS AND MEANS

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III

REVENUE ACT, 1936

MONDAY, APRIL 6, 1936

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D. C.

The committee met at 10 a. m., Hon. Robert L. Doughton (chairman) presiding.

The CHAIRMAN. The committee will be in order. Mr. Cooper, a member of the committee, has just kindly handed me a copy of the Washington Post of April 6, today, one of the headlines being "A. A. A. Benefit Payments Ranging up to Millions Listed by Wallace", and so forth. The story goes on and in the first column it is to the effect that Chairman Doughton, of the Ways and Means Committee, said that the hearings on the appropriation bill will open some time this week, and that one of the witnesses to be called in executive session is expected to be Harry L. Hopkins, head man of the administration's relief set-up.

Of course, there is not a word of truth in that, so far as I have any knowledge of it. I have made no comment to anybody in connection with this matter. That is a subject matter that is in the jurisdiction of the Appropriations Committee, and with which our committee has nothing to do. Why any man who is employed as a newspaper writer would write such stuff as that is more than I can possibly understand.

A story resembling that appeared in the New York Times concerning the matter of a hearing to the United States Chamber of Commerce; that they were protesting because they were being denied a hearing. That is absolutely ridiculous and without one scintilla of foundation. It is regrettable that such a story goes out to the public concerning this committee.

We are perfectly willing to be held responsible for all of our own acts, but not for matters for which there is no foundation. I am sure that most of the newspaper men not only do not engage in the writing of articles of that kind, but do not approve them.

I can say that, generally speaking, I have always had not only fair but generous treatment on the part of these members of the press who have attended our proceedings and written them up.

The first witness on the calendar this morning is Hon. Herman Oliphant, general counsel, Treasury Department.

I have suggested, inasmuch as some members of the House are here, who wish to leave as early as possible to attend the sessions of the House later in the day, that we will call Mr. Oliphant later and hear the Members of the House first.

The first witness, therefore, is the Honorable Wright Patman, a Representative in Congress from the State of Texas.

STATEMENT OF HON. WRIGHT PATMAN, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF TEXAS

Mr. PATMAN. Mr. Chairman and members of the committee: First I would like to suggest a way whereby this money can be raised without having any tax bill at all, if the committee wants to hear me on that. If it does not desire to hear me on that, then I will go to the question of amending the proposed tax bill.

First I say that the tax bill is not necessary. With idle gold to the value of \$10,180,000,000, the largest gold reserve of any country on earth, now in possession of the United States, and the title to it in the United States Government, that idle gold should be used, within reasonable bounds and limitations, for the issuance of Government credit, until that idle gold is used.

After it is used, then, if taxes are necessary, levy the taxes. But I do not think with all of this idle gold unused, it is right to levy any sort of taxes at all.

But I presume that will not be given much consideration by this committee, because I understand the subcommittee has already made a report on a tax bill and I presume it will be necessary for me to discuss it, unless some member of the committee wants me to discuss the subject that I am now mentioning.

Mr. VINSON. I know that my friend from Texas understands the manner in which the legislative power is parceled out to the various committees. I feel sure that he will agree with me that this committee does not have jurisdiction of the matter of currency legislation.

Mr. PATMAN. I thoroughly agree with the gentleman. But if the Ways and Means Committee failed to pass a tax bill, it would cause the other committee to act.

Mr. VINSON. Do you not think that is a function for the House?

Mr. PATMAN. I should say it is; yes.

Mr. VINSON. In other words, it is our duty to report revenue measures to the House. If the House does not see fit to pass them, that is another story.

Mr. PATMAN. For that reason, I will not discuss that suggestion.

The CHAIRMAN. At this point the Chair would feel it his duty to state that in this connection that other Members of the House and other people who are not Members of the House have requested an opportunity to be heard on matters unrelated to the subcommittee's report on the proposed tax bill and they have been informed that the committee had desired to confine these hearings within the scope of the subcommittee's report on taxation.

Mr. CROWTHER. I would like to ask one question, Mr. Chairman, in relation to the statement that the gentleman from Texas has just made.

To what degree is that 10 billion dollars—plus obligated at the present time?

Mr. PATMAN. It is not obligated at all, except in this way, that if the gold is needed to settle trade balances, I think the Treasury should give it up. But that gold cannot leave this country unless the Secretary of the Treasury permits it to leave. The law places the title to all of that gold in the Government of the United States. It does not belong to anyone else. It does not belong to the Federal Reserve banks. It belongs to the Government. The law places the

title to it in the Government. Foreigners who brought their gold here in order to get the increased price for it, brought it here with the knowledge that the title to it would be in the Government. So there is no doubt about it at all.

The CHAIRMAN. Are there some observations you would like to make on the subcommittee report?

Mr. PATMAN. Yes, sir. The bill, so far as I know, is all right. I am not objecting to the bill, if you are going to have a tax bill, except I think there should be one amendment to it.

In 1913 when the Federal Reserve Act became a law, it was then in contemplation that the Federal Reserve banks would not pay taxes, but the profits above 6 percent would go as a franchise tax into the Treasury of the United States into the general fund. That was the compensation that the Federal Reserve banks were to pay for the use of the Government's credit.

Well, as the surplus accumulated, statements were made that they needed new buildings. They bought \$83,000,000 worth of new buildings all over the country. That money was taken out of the surplus fund. Then it was contended that they needed to build up a larger surplus fund. That was permitted, and finally—

Mr. HILL. You mean that was permitted by law, by act of Congress?

Mr. PATMAN. By an act of Congress; yes, sir. Finally a law was passed which permitted 90 percent of all the earnings above 6 percent, after paying the dividends on the stock, to go into the Treasury. That was the law up until June 16, 1933.

At that time there was a bill pending really for the purpose of guaranteeing deposits in banks. For some reason—it was wholly unrelated to the bill—there was a little amendment inserted in that deposit guaranty bill that hereafter all surplus earnings of the Federal Reserve banks would go into the surplus funds of the Federal Reserve banks and not into the Treasury.

Mr. HILL. That was in 1933?

Mr. PATMAN. That was in 1933. It came before the House May 22. I believe it was.

Mr. HILL. What did we get in the way of moneys above the 6 percent prior to that time?

Mr. PATMAN. If you do not mind, Mr. Hill, if you will allow me to finish my statement, I assure you that I will get to that.

I offered an amendment to strike that out; it was not right that that should be done, and it was almost unanimously stricken out in the House. The Senate passed the bill and in conference they put that amendment back. That conference report was held up until just about the day of adjournment or a day or two before. Then it was brought in and we had to vote either for or against the insurance of bank deposits, and of course they forced it into the law, and since that time all the earnings go into the surplus fund of the Federal Reserve banks.

There is a difference there of nearly \$30,000,000 a year. Members of Congress probably did not know that when they voted for it, but they were voting to give these banks about \$30,000,000 a year, and here is what it was based on. The average earnings of these banks during the last 20 years, in addition to the 6-percent dividends on the capital stock, have been \$21,779,000. In 1933 the Treasury lost

\$21,738,000, if that is the average; in 1934 the same amount; in 1935 the same amount; and from here on it will lose that much and more.

That is not the only thing, gentlemen. Before June 16, 1933, there was no incentive for the Federal Reserve banks to charge an agency like the R. F. C. and other governmental agencies for services that they performed, because the surplus went into the Treasury anyway. But since that law passed they have been making charges and they are now making plenty of charges. They are even charging for vault space in these fine buildings that were built with money that should have gone to the Government. They are charging them for space that they use in these buildings. Not only that, they are trying to deduct for taxes and depreciation in addition to vault space and rental on furniture, 8 percent on nonmechanical and 15 percent on mechanical, and so forth; dozens of other items of expense.

Last year these governmental agencies were assessed more than \$1½ million dollars by the Federal Reserve banks. In 1934 they were assessed a large sum. Before 1933 there was no incentive to assess them, as I have said, because it would go into the Treasury anyway.

Now, they are asking for a 40-percent increase. That 40-percent increase will make an amount of over \$6,000,000 a year. They are getting a rake-off on all of this relief money that is going out to the country. They are chiseling in on it. They did not have the incentive before, but they have the incentive now.

I say that the Federal Reserve banks of this country should render some service to the people without charge, in view of the fact that they are operating on Government credit, absolutely free of charge and paying no taxes of any kind or nature whatsoever.

Why should you assess taxes on other banks? Here is a super-bank. It is not owned by the people. They do not own a penny of stock in it. The Government does not own a penny of stock in it. It is owned by other banks. It is a corporation owned by corporations. You are not taxing them one penny—not a penny in the world. They are paying no taxes whatever, but they are making the member banks pay taxes on their surplus.

I cannot see any reason for that. I think they should pay like all other banks. I believe this committee can do this. The profits of the Federal Reserve banks should be captured, which was in contemplation when the original Federal Reserve Act was passed. If you will take those profits and prohibit by law their charging these governmental agencies—and it should be prohibited; they charged the Treasury last year more than \$8,000,000 for handling their bond issues, and they charged the R. F. C. more than \$2,000,000. They are charging all these other governmental agencies, and the charges are getting higher and higher and higher all the time.

If you will put in a little amendment here to take these profits back, just as the original law contemplated, and compel them to render some service for the use of the Government's credit, and not allow them to charge for vault space in these fine banks that were built with Government money, it will mean a difference of \$36,000,000 a year. And that is not a very small sum. It is a large sum.

I just suggest, gentlemen, for your serious consideration, putting an amendment in this bill such as I have mentioned. There is no reason why this supercorporation, a corporation that is above all others, that really controls 98 percent of the bank wealth of this

Nation, should go absolutely untaxed. For that reason I suggest for your consideration an amendment to this bill such as I have described.

Since the committee does not desire to hear me on the first suggestion that I made—and I see the force of the position as indicated by the gentleman from Kentucky (Mr. Vinson)—that is the only statement that I have to make on this bill, unless some member of the committee desires to ask me a question. But I repeat that there is a difference of \$36,000,000 that the committee ought to take into consideration.

Mr. HILL. I want to ask you if we got that before the repeal of that provision.

Mr. PATMAN. We got part of it. Of course, they did use some of it for buildings and for different purposes, but at one time we got \$147,000,000.

Mr. HILL. In 1 year?

Mr. PATMAN. No; it was over a period of some 2 or 3 years. But these so-called perfecting amendments would be offered, and about the time we were to get some large sum of money from the Federal Reserve banks, they would pass a clarifying amendment that would enable the Federal Reserve banks to keep the money.

Mr. CROWTHER. Would that be an income tax or an excise tax?

Mr. PATMAN. It would not be an income tax.

Mr. CROWTHER. Would it be an excise tax?

Mr. PATMAN. I do not know what you would call it. You gentlemen know more about the proper names of these taxes than I do.

Mr. HILL. Would it not be an excess-profits tax?

Mr. PATMAN. I would consider it an excess-profits tax; yes.

Mr. HILL. Well, that is an income tax.

Mr. PATMAN. Just as it was in the original act.

Mr. CROWTHER. If we put that in, we could call that windfall tax no. 2.

Mr. PATMAN. Well, it is really another windfall tax; yes.

Mr. LEWIS. Mr. Patman, if we were to repeal the amendment which changed the original treatment of this, then you think the Government would realize some \$30,000,000 a year?

Mr. PATMAN. I think it would; yes, sir. Over a period of years I know that it would average that.

Mr. LEWIS. When the Reserve System was inaugurated, I believe it was intended to be a substitute for the institution of the Treasury and Subtreasury. I have always regarded it as a governmental institution and only incidentally a private institution. To the extent that banks, as stockholders, derive profits from their holdings in the Federal Reserve System, those profits become a part of the income of the banks and are subject to the ordinary taxation.

Mr. PATMAN. Up to 6 percent only, Mr. Lewis. And they only paid in half of the subscribed capital stock. They have never had to pay in more than 3 percent.

Mr. LEWIS. I am thinking about the corporation tax on incomes.

Mr. PATMAN. Of course, at 6 percent they get, on the small sum that they have invested, an insignificant amount compared to the business which is done by the Federal Reserve System. But all above 6 percent is not taxed; it is exempt. And my idea is that the Government thought that it would get something in the form

of an excess-profits tax, above 6 percent. That was the argument made at that time, that it would make the Treasury money. But it has been diverted.

Mr. LAMNECK. Will the gentleman yield?

Mr. PATMAN. Yes, sir.

Mr. LAMNECK. Was it not originally intended that the Federal Reserve banks should pay a certain rate of interest for the privilege of issuing Federal Reserve notes?

Mr. PATMAN. Yes; and they set the rate of interest at zero.

Mr. LAMNECK. And the bill provided that the Federal Reserve Board should fix the rate?

Mr. PATMAN. Yes.

Mr. LAMNECK. And when they fixed the rate, someone made a motion that it should be nothing, somebody else seconded it, and it was carried unanimously; is not that so?

Mr. PATMAN. I do not know what the minutes would show, but they fixed it at a zero rate, in effect.

Mr. LAMNECK. I have a bill before this committee to tax the circulation of Federal Treasury notes.

Mr. PATMAN. Unless you included the credit, it would not amount to a great deal. If you just included the notes it would not amount to a great deal. If you included all the credit, which should be included, because it is a mortgage upon the property of the people—

Mr. LAMNECK. Would you be in favor of such a bill?

Mr. PATMAN. Yes; I certainly would. The fact of the business is that I think the Government should take over the Federal Reserve banks and use this additional gold. That is what I would like to see done.

The CHAIRMAN. If there are no further questions, we thank you, Mr. Patman, for your appearance and the testimony you have given the committee.

The next witness is Hon. Harry Sauthoff, a Representative in Congress from the State of Wisconsin.

STATEMENT OF HON. HARRY SAUTHOFF, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. SAUTHOFF. Mr. Chairman and members of the committee—

The CHAIRMAN. What phase of the subcommittee report do you wish to discuss?

Mr. SAUTHOFF. I appear in behalf of the dairy group, which is a nonpartisan group of the House, as chairman of the executive committee, to present a request that there be a tax of 5 cents placed on oleomargarine and a tax of 7½ cents on all foreign fats and oils; and that that be included in this bill.

Mr. COOPER. Mr. Chairman, with all due deference and respect, of course, and while we always want to hear our distinguished colleague from Wisconsin, you understand that that is not embraced within the scope of this hearing, do you not?

Mr. SAUTHOFF. I would not go so far as that, Mr. Cooper. I would say that this committee can hear any matters it wants to hear and it has full authority to hold hearings on any question of revenue or taxation.

Mr. COOPER. You are mistaken about that, because the committee has already voted to hold hearings within the scope of this report of the subcommittee.

Mr. SAUTHOFF. Of the subcommittee report?

Mr. COOPER. That is right.

Mr. SAUTHOFF. Now, let me present this further subject matter in line with Mr. Cooper's statement. If we are shut out from presenting this view before this committee on this bill, which seems to be our last stand, then this question arises. If the Senate sees fit to put in an excise tax on, let us say, the dairy products, in which we are vitally interested, then such a bill in the orderly procedure would go to conference, of course. We would like then to be given an opportunity to appear before the Ways and Means Committee and present our views in opposition to any excise tax on dairy products which the Senate might see fit to tack onto this bill.

The CHAIRMAN. The Chair would like to ask the gentleman this question. It is generally known, it is a matter of common knowledge, that when a bill passes the House it is frequently amended in the other body.

Mr. SAUTHOFF. Yes.

The CHAIRMAN. Sometimes very material changes are made, and many of them. Is it customary for committees, after one branch of the Congress places amendments in a bill passed by the other branch and before a conference is held, to reconvene the committee and consider all these other suggestions, or is that a matter that is left to the conferees? You understand, we want to follow the established precedent, the usual custom.

Mr. SAUTHOFF. I appreciate the point that the Chairman is making. I realize what the situation is. But to us this is a matter of such grave consequences that we feel, inasmuch as we cannot now be heard, that at least we should be given an opportunity to be heard in the event such a contingency arises that a processing tax of some kind is levied on the commodities we are interested in, by an amendment inserted in the other branch of the Congress.

Mr. VINSON. Mr. Chairman, in regard to the processing tax, I take it we are in accord with the gentleman from Wisconsin.

Mr. SAUTHOFF. I think so.

Mr. VINSON. There is no processing tax on the products in which the gentleman is interested mentioned in the subcommittee report. I feel certain that the gentlemen who will represent the House as conferees will be happy to have any information which you or your group could give them if such a catastrophe, if I may term it that, should occur in the Senate.

Mr. TREADWAY. Mr. Chairman, I thoroughly agree with the views of the gentleman from Kentucky as to the desirability of the conferees having all possible information, and I go even further than that and think—in fact, I would like to make the motion—but first let me ask this question: Mr. Sauthoff, you say you represent a group of those interested in dairy products, in the House?

Mr. SAUTHOFF. Yes.

Mr. TREADWAY. How many members are in that group?

Mr. SAUTHOFF. Well, we have a list of about 125.

Mr. TREADWAY. About 125 members?

Mr. SAUTHOFF. Representing all political parties, all four parties.

Mr. TREADWAY. And they have formed a sort of bloc of the dairy interests?

Mr. SAUTHOFF. Yes.

Mr. TREADWAY. Are you their spokesman?

Mr. SAUTHOFF. I am chairman of the executive committee.

Mr. TREADWAY. Will there be other Congressmen out of these 125 who will want to be heard or do you represent all of them?

Mr. SAUTHOFF. Yes. I may say, Mr. Treadway, that undoubtedly Mr. Howard Smith, of Virginia, who is our president, Mr. Cullin, of New York, who is our secretary, and various other members are anxious to be heard.

Mr. TREADWAY. Mr. Chairman, in view of what our colleague says—

Mr. REED. Will the gentleman yield?

Mr. TREADWAY. Yes.

Mr. REED. You intended to make a motion, Mr. Treadway?

Mr. TREADWAY. I was not quite certain, but I think I will.

Mr. REED. I would like to ask a question before you make that motion.

Mr. TREADWAY. Very good.

Mr. REED. Mr. Sauthoff, it is your idea that when this matter goes over to the Senate, the plan is to have them put on these processing taxes, and take the blame for this, and all of that will happen without your being given the opportunity to be heard on the merits; is that correct?

Mr. SAUTHOFF. I am just raising the possibility.

Mr. TREADWAY. I think, Mr. Chairman, even recognizing the force of the argument of Mr. Cooper in endeavoring to confine these hearings within the provisions of this informal report of the subcommittee, it strikes me that when a group of 125 of our colleagues want to make a statement through their accredited representative, even if possibly the subject-matter is not germane to the provisions of the report, they should be heard.

I therefore move that Mr. Sauthoff be given the privilege of presenting his case.

Mr. COOPER. Mr. Chairman, I offer a substitute motion for the motion of the gentleman from Massachusetts [Mr. Treadway], that the committee adhere to its former action and hold these hearings within the scope of the subcommittee's report.

Mr. VINSON. And I hope that the gentleman from Massachusetts and his colleagues will vote this time the same way they voted then.

Mr. TREADWAY. We will vote for open hearings, let me assure the gentleman of that.

Mr. CROWTHER. Does the gentleman from Tennessee yield to me?

Mr. COOPER. With pleasure.

Mr. CROWTHER. I call attention to the fact that one Member of the House appeared and was skillful enough to put in his statement incorporating a request for an excise tax before this committee.

Mr. HILL. Who was that?

Mr. CROWTHER. Mr. Boland.

Mr. HILL. It is not in the record.

Mr. CROWTHER. I did not know that.

Mr. COOPER. Mr. Chairman, I ask for a vote on my motion.

Mr. VINSON. Is the gentleman from Massachusetts really serious that he would like to see the hearings opened up? We have tried to expedite these hearings, not exactly hurry them up—

Mr. TREADWAY. Just a moment, if I may, Mr. Chairman. Within my experience—and I have been on this committee some years—we have always extended to our colleagues the greatest degree of courtesy possible, as well as the general public. This is the first time in my experience that it has ever been suggested in connection with tax hearings that a proposed presentation is not germane. This is a hearing on a tax bill. The gentleman from Wisconsin is anxious to be heard on a matter of very great importance to a large section of our country. Why should we lay down a cast-iron rule, especially when there is no bill before us? That is beyond my understanding.

The CHAIRMAN. Of course, those who do not want any bill, will do all they can to defeat a bill and will throw everything they can in the way in order to block a bill. There is not any question about that.

Mr. TREADWAY. Who said so?

The CHAIRMAN. If they do not want a bill, they will throw everything possible in the way of it.

Mr. TREADWAY. We would like to have information.

The CHAIRMAN. I would call the gentleman's attention to the fact that so far as I know he did not vote against the motion that the committee hold these hearings within the scope of the subcommittee report. We would have to go back and rescind the action taken by the committee before that could be done.

Mr. TREADWAY. Mr. Chairman, as a substitute of the motion of the gentleman from Tennessee, I move that we reconsider the vote whereby we laid down the rule of hearing statements only germane to the subcommittee report.

Mr. COOPER. Mr. Chairman, I make the point of order against motion as it is a motion in the third degree and is therefore not in order.

The CHAIRMAN. The point of order is sustained.

The gentleman from Massachusetts has moved that the former action of the committee be rescinded and that we now open up these hearings to Members of the House to present their views on such matters as they may wish to present. What is the breadth of your motion, Mr. Treadway?

Mr. TREADWAY. I intended to limit it to the presentation of the gentleman from Wisconsin who says there are 125 members interested in this subject matter.

Mr. THOMPSON. Will the gentleman from Massachusetts yield to me?

Mr. TREADWAY. I have yielded.

Mr. THOMPSON. What about the matter of other excise taxes that some of us are interested in?

Mr. HILL. There are probably 50 other bills.

Mr. THOMPSON. There are 150 or 175 of those who are situated exactly as is the gentleman from Wisconsin.

The CHAIRMAN. The question is on the substitute motion of Mr. Cooper that the committee adhere to its original action and confine these hearings within the scope of the subcommittee report.

Mr. WOODRUFF. I ask for a roll call, Mr. Chairman.
The CHAIRMAN. The clerk will call the roll.
(The clerk called the roll and the vote was announced as follows:
18 ayes and 7 nays.)

So the motion was passed.

Mr. CROWTHER. Mr. Chairman, I move that a committee be appointed to inform the witness of the action of the committee.
[Laughter.]

Mr. SAUTHOFF. Mr. Chairman, may I make this further statement? I regret exceedingly that I should be the apple of discord. May I ask this? In fairness to this large group, which represents, I might say, fully 25 percent of the agricultural interests of the United States, if it is within the method of procedure of this committee, whatever managers are appointed, in the event the contingency to which I have referred should arise, may I ask that the managers be instructed to give us an opportunity to be heard on this question, which means so much to us?

The CHAIRMAN. Speaking for myself as one of the members who will probably be one of the conferees on the part of the House, I shall be delighted to avail myself of every piece of information on any phase of the bill or any change that may be made to the bill in the other body when it comes back. I feel warranted in saying that both the majority and the minority Members feel the same way about it. I would like to say further that the Chair does not control these matters and does not attempt to. It is altogether a matter for the committee to decide. But, as has been stated, there are quite a number of other excise tax bills before our committee, one of which our esteemed colleagues, Mr. Thompson, is very much interested in, and about which he has been very patient.

I am sure, if we have the time, it will be the mind and the will of the committee to hold hearings on these other tax proposals, some time after this bill is disposed of.

Mr. VINSON. Mr. Chairman, I think it should be stated, so that there can be no question about it, that the processing tax to which the gentleman refers, is not mentioned in this subcommittee report. In other words, the Ways and Means Committee was in accord with the gentleman and struck out the recommendation for a processing tax. I think that if a processing-tax recommendation were in this report, the gentleman and his group certainly should be given an opportunity to be heard. But in all my experience here I have never heard of hearings on a tax proposal that was not in the bill, and particularly when the committee is in accord with the views of the gentleman who desires to make his presentation.

Mr. THOMPSON. Will the gentleman yield?

Mr. VINSON. Yes.

Mr. THOMPSON. Is not the gentleman from Wisconsin here advocating an excise tax on dairy products, on oleomargarine?

Mr. VINSON. The gentleman has been referring to processing taxes.

Mr. THOMPSON. As I understood, when the gentleman came before the committee he wanted to advocate an excise tax on dairy products and oleomargarine; is that correct?

Mr. SAUTHOFF. Not on dairy products; no.

Mr. THOMPSON. That is what I understood.

Mr. SAUTHOFF. On oleomargarine.

Mr. VINSON. The gentleman wanted to make a case against a processing tax on dairy products.

Mr. SAUTHOFF. If I may state my position, it was this, that I advocated a 5-cent tax on oleomargarine and a 7½-cent tax on foreign fats and oils.

Mr. THOMPSON. Those are excise taxes and not processing taxes.

Mr. SAUTHOFF. That is what I said.

Mr. FULLER. Mr. Chairman, I call for the regular order.

Mr. THOMPSON. I misunderstood you.

Mr. SAUTHOFF. Then we are in accord.

Thank you, Mr. Chairman.

The CHAIRMAN. We thank you, Mr. Sauthoff.

The CHAIRMAN. The next witness is Charles B. Newhall, of Boston, Mass.

STATEMENT OF CHARLES B. NEWHALL, REPRESENTING THE BOOTT MILLS, BOSTON, MASS.

The CHAIRMAN. Please state your name, whom you represent, and the capacity in which you appear.

Mr. NEWHALL. My name is Charles B. Newhall, Boston, Mass. I appear here on behalf of the Boott Mills.

The CHAIRMAN. How much time would you like to have?

Mr. NEWHALL. I will not take very long. I only want to deal with one specific detail.

The CHAIRMAN. One phase of the report?

Mr. NEWHALL. The windfall tax; yes.

The CHAIRMAN. Will 10 minutes be sufficient?

Mr. NEWHALL. I will not take much more than that.

The CHAIRMAN. We will allow you all the necessary time.

Mr. NEWHALL. I appear here on behalf of Boott Mills, which is a corporation engaged in manufacturing cotton textile fabrics in Lowell, Mass.

My client wishes to be heard at this time only in connection with one detail which is of vital importance to it in the windfall-tax recommendations of the March 26, 1936, report of the subcommittee on taxation.

The basic assumption on which my client is proceeding is that the intention of this committee is to draft a bill which is equitable and just to all concerned, and that this committee will only too ready to act, if it is pointed out to the committee that a particular detail in the recommendations of the subcommittee will effect an extremely inequitable and unfair result, and that a slight change which is perfectly consistent will accomplish the object of the proposed act and avoid such an unfair result.

I accordingly wish to call to the attention of the committee the ruinous position in which it and other mills similarly situated are placed by the March 3, 1936, deadline, in the following sentence on page 9 of the report of the subcommittee [reading]:

The selling price should be adjusted by the deduction of any amounts subsequently repaid to the purchaser on or before March 3, 1936, or pursuant to a bona fide written contract entered into on or before March 3, 1936, as reimbursement for the amount included in the price on account of the excise tax.

It will be noted that under this language no deductions may be made by a processing mill, even though repayments to customers may have been made after March 3, 1936, because of binding oral, as distinguished from written, contracts with customers, even if such oral contracts were entered into in good faith prior to that date. It will be noted also that under this language no deductions may be made, even though repayments to customers may have been made subsequent to March 3, 1936, because the refunding mill was compelled to do so under written contract entered into after that date.

In other words, it should be borne in mind that the question whether in any particular case a written commitment to a customer constitutes, as a strict matter of law, a contract, may be determinable only through expensive and prolonged litigation.

Of equal importance, it will be noted that under the language no deductions may be made even though repayments to customers may be made by the refunding mill after March 3, 1936, for compelling business reasons.

In other words, under the language, the March 3, 1936, deadline, a mill might be bound legally to its customer to make a refund by an oral contract which was entered into in good faith prior to March 3, 1936, and despite the fact that it was so bound, nevertheless no deduction would be allowed in computing the windfall tax on account of a repayment which it made to the customer pursuant to that binding obligation.

Again, if a written contract was entered into, all in good faith, subsequent to March 3, 1936, and the customer was obligated, by a binding legal obligation, to make such a refund, nevertheless he would be entitled to no deduction whatsoever.

In a number of cases letters have been written to customers, which raised the question whether those letters constitute part of the contract with the customer. There have been separate invoices sent out, separate acknowledgement orders, and it is a very doubtful question whether, in a number of these cases, the written letter constituted a written contract. The customer would claim that it did amount to such a written contract. Nevertheless the Government might claim that it did not constitute such a written contract.

Mr. VINSON. Have you any doubt about it yourself?

Mr. NEWHALL. Oh, yes; I have.

Mr. VINSON. If a person writes a letter and tells a customer that a refund will be made to him to a certain amount, so much per pound, let us say, then the customer buys the goods in accordance with the letter, what doubt can you have about that?

Mr. NEWHALL. You are adding a factor there, in accordance with the letter.

Mr. VINSON. I mean, if the letter goes out to him and this proposal goes out to him and he purchases the goods, of course, that is part of the contract.

Mr. NEWHALL. There is a doctrine of law that the written contract between two parties is bound by the exact writing which is delivered at that time. That is, if a contract is delivered today, and there is a lot of oral or written conversation beforehand, the question whether those earlier writings constitute part of the later contract is an open question.

Mr. VINSON. That is not involved here, because if you had a written contract between the parties subsequent to the writing of the letter, you know that that language would be incorporated in the contract.

Mr. NEWHALL. It is a doubtful question of law how far the earlier writing is embodied in—

Mr. VINSON. You are not concerned with a letter. What you want to do is to have proof as to oral agreements to make refunds. That is really what you are interested in?

Mr. NEWHALL. No; that is one question. The primary question that I have I will now refer to. The greatest asset of mills such as my client—and there are a number in the position of my client—is the goodwill of their customers, without whose business the mill could not continue. A considerable number of competitors of such mills have made and are making refunds to their customers of an amount equal to the tax on the cotton content of the goods sold to such customers on or before January 6, 1936, with respect to which no processing tax was in fact paid to the Government.

In view of this action on the part of a considerable number of competitors, enormous pressure has been brought on my client and other mills similarly situated by their customers, and entirely regardless of such strictly legal rights as their customers may have, in order to maintain the goodwill of these customers, which is vital to their business, my client and other mills similarly situated have no alternative except to make such similar refunds. For compelling business reasons it is absolutely impossible for these mills merely to stand by and do nothing and, of course, if such refunds are made there is no unjust enrichment, so far as these mills are concerned.

An important difference, however, exists between mills in the situation of my client and other mills, or a considerable number of their competitors.

Mr. HILL. If I may ask you this, are you referring to arrangements for refunds after March 3 or prior to March 3?

Mr. NEWHALL. I am referring now to the deadline of March 3, 1936. This is the fundamental proposition, which is one, I think, that in all fairness is absolutely clear. The March 3, 1936, deadline brings about this situation: If mills situated, as my client is situated, should make a refund at this time to their customers, as they are compelled to do really for compelling business reasons, entirely regardless of any contractual obligations, under the suggested wording of the bill, they would be entitled to no deduction in computing the windfall tax. In other words, they would pay back to their customers, and, in turn, they would be subjected to a 90-percent tax on account of the very funds which they turned over to their customers.

Mr. HILL. Have they promised these refunds prior to March 3?

Mr. NEWHALL. They have made oral commitments.

Mr. HILL. No written memoranda of any kind?

Mr. NEWHALL. Well, in some cases there may be letters. The question is whether in those particular cases they constitute a contract.

One other question that I want to raise. I am only addressing myself to a detail and I am going to suggest a way of overcoming

this objection, which is a real objection, which does not affect the objects of the act. I am not suggesting to do away with the dead-line altogether. I am merely suggesting setting a later dead line which will give fair play to all concerned.

Mr. VINSON. I thought we were going to come to that. Now, if the committee were to incorporate the thought that where written evidence had been given prior to March 3, 1936, of the intention to make a refund, that would take care of the case where letters had been written, would it not?

Mr. NEWHALL. That would take care of any case where a letter had been written. But it would not take care of cases where there had not been letters written. It would not take care of cases where there had not been oral contracts.

Mr. VINSON. It would not take care of those cases after March 3, 1936.

Mr. NEWHALL. This is a tremendous problem which my client is faced with. I am not antagonistic at all to your wishes. I am trying to point out a real difficulty which exists.

Mr. VINSON. Did your client write any letters?

Mr. NEWHALL. They wrote some letters, but not in all cases I suppose. I do not know what the exact fact is there.

Mr. VINSON. Were there any of their customers with whom they did not agree prior to March 3, 1936, to make a refund?

Mr. NEWHALL. Did you ask whether they wanted it refunded?

Mr. VINSON. I say, were there any customers with whom they were doing business with whom they did not make an agreement prior to March 3, 1936?

Mr. NEWHALL. Yes.

Mr. VINSON. What you want to do is to permit them to make the agreement now, is that it?

Mr. NEWHALL. In substance; yes. That is, to make that date a little later. If you do that, you are not affecting the object of the act, because the windfall tax is levied not only on processors but on nonprocessors who, in turn, have passed on the tax. So that there is no difference between the results from the point of view of the act, if you follow my suggestion. It is just changing the date.

Mr. VINSON. It would make quite a difference, would it not?

Mr. NEWHALL. I do not think so.

Mr. VINSON. It would make quite a difference in the revenue, would it not?

Mr. NEWHALL. I do not think so, sir, because, as I say, you have a tax which is imposed on dealers, on nonprocessors. So that you collect the tax, instead of from A, you collect it from B. This is a practical situation that my client and the others are faced with. It has kept us awake nights worrying about it because, as I say, the good will of customers is involved.

Mr. VINSON. It would be just as practical a situation for B as for A.

Mr. NEWHALL. I beg your pardon?

Mr. VINSON. If you let A out and put it on B, he has got a practical situation to face, has he not?

Mr. NEWHALL. This would apply to everybody. I am not asking for any particular individual, I am not asking for the pointing out of any one person.

Mr. VINSON. But B would not be in the position to make a promise to C based on this deadline date. A owes the tax now, and you bring this date down, say, to June 1. Well, we will not make it that absurd. We will say April 1. B cannot make a promise to C that he will pass it on until he gets that money from A.

Mr. NEWHALL. Yes; he could make a promise in this way: He could say, "If I do get the money from A, I will pay it to C."

Mr. VINSON. But that is not a very definite promise. That is a conditional promise.

Mr. NEWHALL. But it is a promise. It would bind him. In case a refund were made to him, it would protect everybody down the line.

Mr. HILL. Will the gentleman yield?

Mr. VINSON. Yes.

Mr. HILL. You have in mind particularly your processors, have you not?

Mr. NEWHALL. Yes, sir.

Mr. HILL. They had 57 days, or practically that, from the time the Supreme Court, on January 6, held this processing tax invalid, until March 3, when the President sent his message to Congress advocating or suggesting such a tax as this windfall tax is. Now, if they were so solicitous to make these agreements with their customers to refund to them the amount they had paid by reason of the processing tax, it seems to me they had ample time in which to do it.

Mr. NEWHALL. If I may address myself to that point, take my client as an example. There has never been any intention on the part of my client to profit in any way by these amounts. They have always intended to do the fair thing by their customers. Now, the only reason why no definite writings of any kind, in the form of a formal, binding contract, aside from maybe in a few cases informal letters, if there were such—I am not sure on that point—the reason why no such contract was made by them was that it was not clear exactly whether they would be able to pay that back or not; whether there would be a tax imposed on them which would prevent them from paying it back. In other words, if they paid that money over to their customers, they were subjecting themselves to the risk that some statute would be enacted which would tax those funds in their hands, and they would be subject to the same situation that they are now of double taxation. That is, they would be paying back to their customers without any refund.

Mr. HILL. But there had been no statement from any legislative or executive source, except shortly prior to March 3, perhaps, that such a tax might be contemplated.

Mr. NEWHALL. There was a lot of public discussion as to a retroactive tax. That was one point that we, for example, had in mind, I think from the very beginning, and that was the one crucial question. These mills are not trying to accomplish anything which is in any way inequitable.

Mr. HILL. I am sure it would not apply to your mill; but there might be instances in which it might be better-business practice for a processor to refund this money to the customer than to pay a large part of it in taxes to the Federal Government. In other words, you might find that now and then at least a processor who, knowing that he was going to have to respond to a heavy tax on this

particular character of income, might say, "Well, if we have to pay the money out, let us pay it to our customers." But if this impelling reason—this tax, which is the impelling reason—were present, he might not even then consider refunding it to his customers. You might have instances of that kind, which would deprive the Government of some revenue. I am not ascribing this to your client.

Mr. NEWHALL. This money that is paid over to a customer is in turn taxed. That is, there is no deprivation of revenue to the Government. It is just taxing it in other hands rather than in the hands of the processor.

The fundamental point that I wish to make is that this is a practical business question. Here we are confronted with this problem: Are we going to make these refunds or not? Now, for the purposes of goodwill, these customers having obtained refunds from other mills, there does not seem now to be any alternative except to pay it to them. Now, if we had to pay it—

Mr. HILL. That comes back to the question I asked you previously. You have had almost 2 months before the President's message came down, on March 3, in which to promise to your customers, or agree with them, that you would refund this tax, and for some reason you have not done it.

Mr. NEWHALL. But the reason that was not done was because of the risk that if it were done the mill would be subjected to another tax.

Mr. HILL. You say that other mills have made refunds. Why should you not do the same?

Mr. NEWHALL. These other mills, in large part, did have such written contracts; that is, a number of the mills did have such binding, written contracts with their customers. They were worked in as part of the acknowledgement order forms and the invoices. That is, here we have a situation where competitors are placed in a different position.

Now, I would like to indicate to you just how this would work, if this date is not shifted to a later date. Assume that a mill in the position of my client is not allowed a deduction. The result is that the dealer who has received a refund from us has a tax imposed upon him—a 90-percent tax. If he has, in turn, passed on the tax to his customer, a 90-percent tax, by hypothesis, is imposed on a mill situated as my client is situated. In other words, under those circumstances there are two 90-percent taxes collected with respect to the same tax content. One 90-percent tax is imposed on the processor, and still another 90-percent tax is imposed on the dealer.

Mr. VINSON. In that case, when did your client make the refund?

Mr. NEWHALL. It has not actually made the refund yet.

Mr. VINSON. If it has not, then they have nothing to tax.

Mr. NEWHALL. Well, Mr. Vinson, the point is that this mill has to make the refunds.

Mr. VINSON. I know; but the mill will not make the refund if the Congress of the United States fixes a deadline, which it certainly would have to fix. The deadline you would suggest might not suit somebody else's client; but certainly, if you have a deadline, it does not seem to me that you would lose the goodwill of your customers. They are certainly going to have to be bound by the law.

Mr. NEWHALL. Well, that is not the way customers' minds work, Mr. Vinson. The customers see the actual cash coming in to them from certain other processors, and they see no cash coming from us.

Mr. VINSON. Have you made a single refund?

Mr. NEWHALL. I am not sure. There may have been some refunds made.

Mr. VINSON. But so far as you know you have not made a single one?

Mr. NEWHALL. I do not know either way, sir.

Mr. VINSON. Now, so far as this double taxation is concerned, your client is going to hold that money until you find out what the law is?

Mr. NEWHALL. No; my client says that it cannot hold it. For practical business reasons they have to pay it over. It is just a case of throwing up their hands unless they pay this money to their customers; and if they do pay this money to their customers, as I say, it reaches this inequitable result.

Mr. VINSON. On what date are they going to pay it? What is the deadline so far as their payment is concerned?

Mr. NEWHALL. The deadline has not been fixed so far as their payments are concerned; but I do not quite see how that is material.

Mr. VINSON. It is material as to whether they will pay it or not. That is the point with us.

Mr. NEWHALL. But you set a deadline, and so long as everybody is treated fairly, with opportunity to comply with that deadline, then it is up to them to comply with it.

Mr. VINSON. What deadline would you fix?

Mr. NEWHALL. I would fix a deadline which is a reasonable time after the enactment of the statute.

Mr. VINSON. You mean after the enactment of the statute?

Mr. NEWHALL. Yes, sir.

Mr. VINSON. Oh, I see. You go a little further than I understood you did.

Mr. NEWHALL. It would depend on the date of the enactment of the statute. Then it reaches a perfectly equitable result.

Take another aspect of this matter. If we are not allowed a deduction on account of these refunds which we are compelled to make, let us assume that our customer had floor stocks on hand on January 6, 1936; if he had obtained refunds from us, presumably he would not be entitled under your proposed act to obtain refunds again from the Government; otherwise he would be receiving 90 percent from us and 90 percent from the Government. The result of that would be that since the customer, the dealer, is not entitled to a refund by hypothesis from the Government, we are not entitled to any deduction on account of this voluntary repayment at this time. A tax has been paid by us with respect to these goods which are held on January 1936.

Mr. VINSON. Then would you not have to wait until it is determined whether or not the man got his refund on his floor stocks before you could in safety pay out this money?

Mr. NEWHALL. But we would not do it for business reasons. It is absolutely impracticable.

Mr. VINSON. It looks as if you are working this up into a double taxation system, anyhow.

Mr. NEWHALL. So long as you do what I am suggesting, set a fair deadline, it does not change the object of your act at all.

Mr. VINSON. Assume that we fix the deadline at the date of the enactment of the law. Now, you have floor stocks, have you not?

Mr. NEWHALL. That is right.

Mr. VINSON. That man is entitled to a refund, is he not?

Mr. NEWHALL. A refund on stock held January 6; yes, sir.

Mr. VINSON. Floor stocks?

Mr. NEWHALL. Held on January 6; yes, sir.

Mr. VINSON. Now, I made the statement a minute ago that for you to be safe you have got to wait until this man works out his floor stock tax refund, because if you pay it to him you may get soaked again.

Mr. NEWHALL. But we cannot do that as a practical matter. These customers are clamoring. There is immense pressure being brought to bear on us. They say, "You have got to pay us this amount of money." Now, as I pointed out in the beginning, the goodwill of our customers is the most valuable asset we have.

Mr. VINSON. What is the amount involved in the case of your client?

Mr. NEWHALL. In this particular case I should say a total, perhaps, of around \$300,000; but there are other mills, too, which are similarly situated.

Mr. FULLER. Let me see if I understand you. You sell, let us say, to a wholesale house, and you pass the processing tax on to the wholesale house?

Mr. NEWHALL. Let us assume that; yes, sir.

Mr. FULLER. Well, that is what you are talking about?

Mr. NEWHALL. Yes, sir.

Mr. FULLER. You pass it on to the wholesale house. They have paid you, and you are supposed to pay that in. Now, since the law has been declared unconstitutional, this wholesale house comes to you and says: "That law has been declared unconstitutional; therefore, we want you to return to us this processing tax that we paid you." That is what they are clamoring for?

Mr. NEWHALL. That is it, exactly.

Mr. FULLER. Didn't they pass it on?

Mr. NEWHALL. But they are in turn refunding that to their customers.

Mr. FULLER. Didn't they pass it on?

Mr. NEWHALL. I say, to the extent that they passed it on, they in turn—

Mr. FULLER. They passed it on to the retailer?

Mr. NEWHALL. They are refunding it to their customers.

Mr. FULLER. They pass it on to the retailer and so on to the consumer?

Mr. NEWHALL. They pass it on one further step in one case that I have in mind. But they are now actually making refunds. In connection with Mr. Vinson's question, the largest customer of this particular mill is, as a matter of fact, making refunds, if they are not already completed, which in turn, as a business matter, compels us to make these refunds to them.

Mr. FULLER. Now, then, you want to satisfy them for a demand that they are making of you, in view of the fact that they realize, know, or think that this Congress is going to pass what is known as a windfall tax in order to get that tax into the Federal Treasury? Yet they are demanding of you that you pay them back that tax now?

Mr. NEWHALL. Exactly.

Mr. FULLER. Well, if you do not pay it back, will not all the rest of the men that they apply to be in the same attitude that you are?

Mr. NEWHALL. No, sir.

Mr. FULLER. Why?

Mr. NEWHALL. Because in a number of cases these other mills have done one of two things. They have either made actual refunds prior to March 3, 1936, or they have entered into what are clearly legal, binding, written contracts to make such refunds; so that they are entitled to a deduction under this present deadline. But mills situated as my client is situated are not so entitled.

Mr. VINSON. You did not make up your mind to do this in time.

Mr. NEWHALL. The point is that these other mills entered into contracts and took the risk. They assumed a real risk in entering into such contracts.

Mr. VINSON. I say, you just did not make up your mind between January 6 and March 3?

Mr. NEWHALL. Yes; because of this question of double liability.

Mr. VINSON. That is right.

Mr. NEWHALL. But I am just pointing out the actual situation that my client and a number of others are facing.

Mr. VINSON. Of course, you recognize that oral agreements are much easier to prove than written memoranda or written contracts?

Mr. NEWHALL. Yes; but—

Mr. VINSON. You recognize also that that opens the door—not to your clients, of course, but to some folks—to take advantage of that sort of thing?

Mr. NEWHALL. But you say it is easy to prove.

Mr. HILL. It gives it more elasticity.

Mr. NEWHALL. I am a processor. You say it is easy to prove. It is easy for my customer to prove, and therefore I, who have entered into an oral contract, am placed on this position—that my customer has, as you say, an easy job to prove an oral contract on my part to make such refund. Of course, this has been talked over between the customers and the processors for a long time.

Mr. VINSON. Is there any question as to the oral agreement being subsequently voided?

Mr. NEWHALL. I do not think so, if it is a supplemental agreement, not in connection with the primary sale of goods. That is, it can be a separate contract.

Mr. VINSON. Then certainly, if it is not, that letter that we talked about a while ago is pretty good evidence of a contract, is it not?

Mr. NEWHALL. It is evidence of a contract, but you also have the legal problem of integration of a contract with all previous writings, conversations, and so forth, being embodied in the final document. Now, the final document in these particular cases is an order given

by the customer: "Supply so many goods at such and such a price", which is acknowledged.

Mr. VINSON. And it is based upon this proposal made in the letter, and which, when they sign this order, is in law an acceptance. In other words, that letter is merely a question of price?

Mr. NEWHALL. That letter is an informal letter that has been sent months before. The point is this: You have several groups of cases. We are addressing ourselves to just one particular group, where there may have been a few letters. The point is that whether you are right in saying that there is a binding contract, in cases where such a letter was written, or whether I am right if I say definitely that there was not, that that is a question to be decided by a court.

Mr. VINSON. We can put language in the bill to make that clear. Certainly, if a letter has been written and an express agreement or proposal has been made to make a refund, the Government of the United States ought to recognize that. It is reduced to writing and is in good faith. But the gentleman is going pretty far when he comes in here and wants to have those things made subject to oral contracts. That is the point. The gentleman is a lawyer, and he recognizes the condition that obtains in regard to matters of that kind.

Mr. NEWHALL. But, Mr. Vinson, what I am saying comes down to this: In most cases, entirely aside from this question of informal writings—entirely aside from that question—the problem is, if there be no such writings, as in most cases I think there were not, then my client is placed in the position of being forced, for practical business reasons, to make these very substantial refunds, and yet it is not entitled, under this deadline, to any deduction or any allowance on account of such refunds, and by pushing that date along to a later date it does not void the object of your act in any way because you impose a windfall tax on nonprocessors. You get them.

Mr. FULLER. In other language, you want the date extended so that you can return this \$300,000 in processing tax to the wholesaler that you sold to?

Mr. NEWHALL. That is right. We have got to do that.

Mr. FULLER. Then we would proceed to get it from him instead of proceeding against you?

Mr. NEWHALL. That is right.

Mr. FULLER. In other language, the verbal contract that you have referred to may possibly develop in this way: That the wholesale house that you are selling to will come in and prove that your agent or some of your representatives said to him, "You buy these goods; we will charge you this processing tax, but if it is declared illegal, then we will remit it back to you." Is that what you mean by these oral contracts?

Mr. NEWHALL. There might be some oral contracts.

Mr. FULLER. What other kind of oral contract could enter into this question that we are talking about?

Mr. NEWHALL. There would be merely oral commitments, yes; it would be that in substance—that "if this tax is an illegal exaction, declared to be so by the United States Supreme Court, then we will pay that money back to you."

Mr. FULLER. Yes. Now, these people make that demand on you in view of the fact that the President has asked for a tax on it,

and it is generally known all over the country, by the people who make the demand, that we are going to require you to pay that tax into the Treasury, that 90 percent—still they are exacting of you that you return it?

Mr. NEWHALL. Exactly.

Mr. FULLER. And for business reasons you would like to have the date changed so that we will collect it from them instead of you, so that you can pay the money directly back?

Mr. NEWHALL. The point is that we have got to pay it. It is not a question of your changing the date and our making the refund. It is a question of being compelled, in order to retain the goodwill of these clients, however unreasonable their demands may be. I am not arguing how reasonable they are. But the point is that they are making the demands, and in order to retain their goodwill we are compelled to meet them.

Mr. FULLER. You are not compelled to meet them unless you pay it before this law goes into force and effect.

Mr. NEWHALL. Yes; we are compelled to make pretty prompt payment right now.

Mr. FULLER. Oh, no. Certainly you are not going to turn loose \$300,000 or any other considerable sum unless you have a good idea that this law is going into force and effect and we are going to hold you responsible for it.

Mr. NEWHALL. The bill says we have got to.

Mr. FULLER. I know they do.

Mr. TREADWAY. Mr. Newhall, I understand that your group of mills employs about 300 hands?

Mr. NEWHALL. I do not know just what number of hands they do employ, but they are a very sizable mill.

Mr. TREADWAY. How many others are there in the East—in the New England States, for instance—that are similarly situated? Let me put it this way: How many competitors of the Boott Mills are there on the products that they turn out?

Mr. NEWHALL. I am afraid I am not up on that exact number. I know that there are a very large number of such concerns.

Mr. TREADWAY. I rather inferred that some have gone ahead, irrespective of what the law is likely to be, and made these refunds; or have they all held up the refunds?

Mr. NEWHALL. No; there have been a number who have made refunds. In large part those people who have made refunds have done so pursuant to some sort of written contract which they entered into before March 3, or they made those refunds before March 3. But there are a considerable number, I understand, who are not in that category.

Mr. TREADWAY. Then, if the Boott Mills did not have that kind of a contract with their customers, and are now awaiting legislation, whereas their competitors did have a contract, and made the refunds, you argue that the Boott concern is handicapped in relation to goodwill with the purchasing public?

Mr. NEWHALL. Exactly. They cannot do business without retaining such goodwill, and the competitors are making refunds, which puts the Boott Mills in the position that they, in turn, in order to maintain that goodwill, have to make such refunds.

Mr. TREADWAY. As far as the quality of the goods manufactured is concerned, they are practically all more or less identical; are they?

Mr. NEWHALL. Yes, sir.

Mr. TREADWAY. Now, you consider goodwill as a very large item, do you not?

Mr. NEWHALL. In my opinion, it is the most valuable asset which a mill can have. Without such goodwill it cannot continue in business.

Mr. TREADWAY. You would not limit it to mills, would you?

Mr. NEWHALL. No; anybody.

Mr. TREADWAY. Any business?

Mr. NEWHALL. Yes, sir.

Mr. TREADWAY. It happens that I have a little line of business—not a mill—and if we lost goodwill we would quit. That applies to almost any business, does it not?

Mr. NEWHALL. Exactly; yes, sir.

Mr. TREADWAY. So that, having carefully studied recommendation no. XXIV, you are in a position to testify for your client that if the suggestions contained in recommendation XXIV are actually written into legislation, the Boott Mills will suffer severely?

Mr. NEWHALL. Exactly.

Mr. TREADWAY. That is all I want to ask, except this: Can you give us any idea how many other mills are similarly situated that are not appearing here with you today; mills that are in the same tax position as the Boott Mills?

Mr. NEWHALL. I have not made a canvass of the mills in general, but I know of my own knowledge that there are several which are situated in that way, if not in full, some of them at least in part. That is, they may have made written contracts prior to March 3 with some customers, but not with all.

Mr. TREADWAY. And it is a question of good faith in living up to those contracts with their customers, and therefore they secure their goodwill; but there is no good faith involved with your client?

Mr. NEWHALL. Well, there is good faith involved, because—

Mr. TREADWAY. But I mean so far as any contract is concerned.

Mr. NEWHALL. So far as any contract is concerned, no; but moral contracts, so far as we are concerned, and others, surely exist. On the same premises, of the necessity of retaining goodwill, it is necessary for us to do the fair thing by our customers.

Mr. TREADWAY. You are convinced that carrying out these suggestions on pages 8 and 9 would be a very serious detriment to mills situated similarly to the Boott Mills?

Mr. NEWHALL. Yes, sir; and I am suggesting a way in which the basic object can be accomplished without doing any injustice to anybody, whereas this is accomplishing the object of doing injustice. And I cannot see why the committee should not be willing to make a slight change, which would not affect their object, but would still avoid this injustice which I have pointed out. It is a practical injustice which actually exists.

The CHAIRMAN. I understand you to say that you have a class of customers who expect you to do something that you have not agreed to do, that you made no contract to do, and are under no obligation to do; that if you do that, it is your own loss. If you refund them

something that you have not agreed to refund, you sustain the loss yourselves; but if you do not do that, you are going to lose their goodwill?

Mr. NEWHALL. That is right.

The CHAIRMAN. You have a very peculiar class of customers. They have no contract with the others. They cannot get it from the others—your competitors—and yet they are going to get mad at you and deprive you of the business and turn that business over to some other concern just because you do not do something that you have not agreed to do, and are under no obligation, morally or legally—

Mr. NEWHALL. There is a moral—

The CHAIRMAN. Wait a minute. There could not be a moral obligation unless you agreed to do it—to pay it out of your own pocket. If you take this money out of your own pocket and pay it over to them, they are getting this money as a bonus, because they have bought these goods and sold them, as I understand. The logical conclusion would be, would it not, that they would have to go on down the line to the ultimate consumer before justice was done? They have no right to ask this money of you unless they are going to carry it down and down and down.

Mr. NEWHALL. Take a processing mill. It will make a refund to its customer. Now, its customer will be in one of two situations: Either he has resold those goods and passed the tax on, or he still had those goods on hand, say, on January 6, 1936. Now, if he had resold those goods and passed the tax on, he would be subject to the 90-percent tax.

The CHAIRMAN. He is not a processor.

Mr. NEWHALL. No; but the proposal here is to impose a tax on dealers as well as processors; on nonprocessors as well as those who process.

The CHAIRMAN. Where would you finally stop it? How far would you pass it on? How far would you continue to refund in order that equity might be done?

Mr. NEWHALL. I am representing a processor who makes a refund to its customer. Now, so far as I am concerned, I have not been unjustly enriched, have I? I have received certain money, and I have turned it back to my customer. I have not been unjustly enriched.

The CHAIRMAN. You have not yet.

Mr. VINSON. Take it right along back, where do you wind up?

Mr. NEWHALL. Take what back?

Mr. VINSON. Your refund. You get rid of it; you pay it to your customer?

Mr. NEWHALL. Yes.

Mr. VINSON. Then he gets rid of it and pays it, say, to a jobber?

Mr. NEWHALL. Yes.

Mr. VINSON. The jobber gets rid of it and pays it to the retailer. Then what else? Where does the consumer come in?

Mr. NEWHALL. You tax the retailer, if it goes all down that line.

Mr. VINSON. Logically, of course, the thing for him to do would be to refund it to the consumer.

Mr. NEWHALL. Well, that would be impossible.

Mr. VINSON. That is what I say.

Mr. NEWHALL. That would be impossible. It should finally get to a point where you could impose your tax, even if you assume this long line of refunds, which we do not know will exist.

Mr. VINSON. Then it would be necessary for the Government to follow through each step and have lawsuits—a multiplicity of actions, which the people of law abhor. According to your theory, you would have to have lawsuits clear down the line to see that these things were done.

Mr. NEWHALL. Well, you are doing that in part already.

Mr. VINSON. No; if we just had one, and the fellow who won it got the money, that would simplify it, at least in a material degree.

Mr. NEWHALL. But you already have that problem, Mr. Vinson, under this present deadline. You already have that problem.

Mr. VINSON. We do not have it in the cases you have referred to, where the money is collected and is being held there ready to turn into the Treasury, which is an admission on your part that they did pass it on.

Mr. NEWHALL. Well, in this particular case we will be compelled to pay it back.

Mr. HILL. Your operation, carried out to its logical conclusion, would be just as indicated here. It gives the retailer the opportunity of passing the tax on to the consumer—hundreds of thousands of them—instead of a comparatively smaller number up the line. But if the retailer passes it on to the consumer, then if the Government gets any tax at all, it has got to go to the consumer to get it. That would be the logical sequence of your operation. Now, as a matter of fact, you had 57 days after this law was declared invalid in which to make arrangements to pay back, or else to actually pay back this tax, and you have not done that, as I understand.

Mr. NEWHALL. No; but you understand the reason why that was not done. It is absolutely impossible to tell exactly what kind of retroactive tax will be enacted.

Mr. HILL. Well, the other mills that you say have made refunds were not so deferred.

Mr. NEWHALL. But I have pointed out that in a very large number of those cases they had entered into contracts which bound them to make such refunds.

Mr. HILL. I think the committee understands your point.

The CHAIRMAN. Are there any further questions?

(There were no questions.)

The CHAIRMAN. We thank you for your appearance and for the information you have given the committee.

(The following memorandum was submitted by Mr. Newhall:)

SUPPLEMENTAL MEMORANDUM OF CHARLES R. NEWHALL ON BEHALF OF
BOOT MILLERS

In order to clear up an apparent misunderstanding, I wish to point out that the refunds which Boot Mills (and other mills similarly situated) will, for overpowering business reasons, be compelled to make at this time, will be solely with respect to floor stocks on January 6, 1936, held either (1) by immediate customers of Boot Mills (and other mills similarly situated), or (2) by customers of such immediate customers.

It is my understanding that the stated intention of the proposed bill is that such floor stocks held on January 6, 1936, shall "move into the channels of trade, equally untaxed."

However, this will not be the case under recommendations of the Subcommittee on Taxation, at least so far as processors are concerned.

Under these recommendations, processors (and presumably nonprocessors) are not entitled to any deduction on account of refunds which they make subsequent to March 3, 1936, otherwise than pursuant to a written contract entered into prior to that date. As has already been pointed out, overpowering business reasons will compel Boot Mills (and other mills similarly situated) to make the refunds above indicated, although they are probably not legally obligated to do so by any written contract made before March 3, 1936. Presumably, however, customers to whom such refunds were made by their suppliers would be barred from obtaining a floor-stock refund from the Government by reason of having already received a refund on account of such floor stocks from their suppliers. This would, of course, mean that all suppliers making such refunds would in substance be paying a windfall tax to the Government on account of floor stocks held by customers on January 6, 1936, and no one would be entitled to receive a refund from the Government on account of the tax content in such floor stocks. As a result, such floor stocks would move into the channels of trade taxed to the supplier, not untaxed. The same line of reasoning applies to floor stocks held on January 6, 1936, by customers of the processing mills' immediate customers, as well as to such immediate customers. Boot Mills' immediate customers have in some cases already made refunds to their customers on account of their floor stocks on January 6, 1936, and in other cases will be compelled for overpowering business reasons to do so. For this reason Boot Mills is compelled to make its immediate customers whole on account of such refunds made by them.

With respect to such nonprocessors' floor stocks held on January 6, 1936, it should make no difference to the Government whether refunds to the person holding such stocks are made by the supplier or by the Government. If the supplier makes the refund to the customer, it is merely doing for the Government what the Government would otherwise do for itself.

It is merely equitable that the new revenue act should not penalize mills in the position of Boot Mills, for doing what the Government itself feels is the fair thing to do. There is no basis of "unjust enrichment" on which to found any windfall tax on such mills with respect to the amounts so refunded, and if a proper deduction is allowed, the Government would not be adversely affected so far as collection of taxes is concerned. The stated object of the proposed bill is that no taxes should be retained by the Government with respect to floor stocks held January 6, 1936.

A suggested method of avoiding the inequitable situation with respect to customers' floor stocks on January 6, 1936, is to change the March 3, 1936, deadline to a reasonable time after the enactment of the law. It is probably possible to work out some other method of avoiding the inequitable situation created by the present recommendations. It should be borne in mind, however, that the repayment to customers by Boot Mills must be made at this time.

The CHAIRMAN. We will call again—we called him this morning, but he was not here—Hon. Samuel B. Pettengill, a Representative in Congress from the State of Indiana. Mr. Pettengill, we will be pleased to hear you now.

STATEMENT OF HON. SAMUEL B. PETTENGILL, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF INDIANA

Mr. PETTENGILL. Gentlemen of the committee, I note that you are very much pressed for time. I have a statement here that would take 15 minutes to read. I will omit reading it and direct my attention informally to what I think is the worst feature of the bill.

The CHAIRMAN. Do you wish the statement inserted in the record?

Mr. PETTENGILL. Yes; if you please.

The CHAIRMAN. Without objection, it will be incorporated in the record.

(The matter referred to appears at the close of Mr. Pettengill's statement.)

Mr. PETTINGILL. It seems to me, gentlemen—and I know that the point has already been developed in previous testimony—that the inevitable effect of the bill is to place the younger and weaker competitor at a great disadvantage as against the unit in the industry that is very well heeled. It is an astonishing result, gentlemen, as I understand the bill, that General Motors—and I use that company simply as an example—with a tremendous reserve, by paying out all of its future earnings, is entirely exempt from tax. That is an astonishing result of a tax bill—one of the giants of American industry may pay no taxes whatever to the support of this Government, and its competitor in the production of electric refrigerators or automobiles, which is under the necessity of retaining its earnings, will pay a tax of from 22½ to 42½ percent or from 50 to 183 percent more than it is now paying.

Now, if each of these competing industries produces 42,500 units, and one with a net earning of \$1,000,000 pays a penalty tax of \$425,000 and the other with the same net earnings pays nothing, it simply means, as I see it, gentlemen, that you are subsidizing the stronger competitor to the extent of \$10 per unit of product.

Mr. VINSON. What company do you have in mind that would be a competitor of General Motors and would pay that 42½-percent rate?

Mr. PETTINGILL. Well, I say from 22½ to 42½ percent.

Mr. VINSON. But when you figure it out, you figure it at \$425,000.

Mr. PETTINGILL. That is purely as an illustration. If I use 22,500 units as against a tax of \$225,000, the advantage would be the same.

Mr. VINSON. The point I am making is this: The gentleman is very much interested in a concern in his district, I take it.

Mr. PETTINGILL. That is correct.

Mr. VINSON. And we have had some discussion about it.

Mr. PETTINGILL. That is right.

Mr. VINSON. The gentleman made a real contribution in connection with that—the Studebaker crowd!

Mr. PETTINGILL. I am not speaking for Studebaker alone. The same point might be made for Hudson, Reo, Dodge, Packard, and so forth, or the competing units of any other business—typewriters, electric washers, or a thousand others.

Mr. VINSON. I am speaking of that as an illustration.

Mr. PETTINGILL. That is right; purely as an illustration.

Mr. VINSON. But they have a bond issue, and, as I recall it, a prohibition against declaration of dividends.

Mr. PETTINGILL. That is correct.

Mr. VINSON. And, of course, they have special treatment here.

Mr. PETTINGILL. That is correct, Mr. Vinson. But the point is this: That General Motors under that situation might pay no tax, and the tax on Studebaker and Hudson and Reo would be increased at least 50 percent, even though they were given the benefit of all the exemptions on account of contractual debt obligations, and so forth.

Mr. McCORMACK. You do not mean to say that they do not indirectly pay a tax! It reflects back on the individual stockholder.

Mr. PETTINGILL. That is true, Mr. McCormack. The individual General Motors stockholder would pay the tax to the Government. That is correct. But we have to think first of the corporations themselves, upon whose survival in business the tax-paying ability of the stockholders necessarily depends. It is necessarily true that if there are two competing units, whose net earnings in 1 year are a million dollars each, and one distributes all of its net earnings to its stockholders, and the other, from the necessities of debt-retirement, or expansion, retains them, that second competitor will have to pay at least \$225,000. All taxes must be charged into operating and selling costs. Now, if both units in the industry, competing with each other, produce 22,500 units of their product, you are giving the big industry an indirect subsidy of \$10 per unit by which it can undersell its competitor.

Now, on an automobile that would not be very much, but on a typewriter or electric refrigerator, or a washing machine that wholesales at \$50, that \$10, under the illustration I have given, is a subsidy given by this Government to the large competitor of 20 percent. And I cannot believe that that is the result that this committee intends to happen. It seems to me that the inevitable tendency of the bill is to freeze for the future whatever competitive advantage the large now enjoys over the small, and that the bill means still further concentration of economic power in the hands of a few gigantic combinations of capital.

That is one point that I want to bring to the attention of the committee.

Another point, gentlemen, is this: By shifting from the corporation as a taxpayer to the corporation's stockholder as the taxpayer, it seems to me that you necessarily defer the collection of revenues by one whole year; and unless you are able to devise some practical means of overcoming that objection, you are going to have a gap or a hiatus in the collection of hundreds of millions of dollars of revenue for 12 months. If the present corporation income tax is retained, and the corporation makes an earning in 1936, it pays taxes in 1937, and I understand it is estimated that under existing law, the amount would be \$800,000,000, but under this proposed plan, if it makes an earning in 1936, it may distribute it to its stockholders in the first 2½ months of 1937 and the corporation pay nothing in 1937 and the stockholder does not pay any taxes thereon until 1938. The result is that the Government has dropped out a year from its tax calendar.

Now, the proposal of the committee allows 2½ months for the corporation to make that excess distribution of its earnings to its stockholders, from January 1, 1937, to March 15, 1937; and if it does so, and the corporation pays all of its earnings to its stockholders, the corporation is wholly exempt, but the stockholder has received his dividend in the year 1937, and he does not account therefor and pay taxes thereon until 1938.

It seems to me that that is a point of tremendous interest, not only from the social and economic implications of the bill, but from the fiscal standpoint of the United States Government, which needs the money in 1937.

I thank you very much.

Mr. VINSON. Mr. Pettengill, on the last point, of course, your illustration in regard to the fact that no corporate tax would be paid for the calendar year 1936 is based on a condition that is not very likely to happen, and that is that all income from corporations would be declared out in dividends.

Mr. PETTINGILL. I appreciate that.

Mr. VINSON. In other words, the corporate tax for the calendar year 1936 would be collected just as it would be under the flat rate.

Mr. PETTINGILL. It might, or it might not. Some corporations will pay more than the present 15 percent and some will pay less.

Mr. VINSON. Now, the amount of the corporate tax for the calendar year, which is the taxable year, 1936, of course, would depend upon the amount that would be placed in surplus.

Mr. PETTINGILL. That is correct.

Mr. VINSON. It would require 100 percent distribution to drop the corporate tax completely out.

Mr. PETTINGILL. That is correct.

Mr. VINSON. I think you made that statement clear, but I wanted to amplify it.

Mr. PETTINGILL. Yes; but the force of my objection, Mr. Vinson, is pro tanto, anyhow. To the extent that the corporation in the first 2½ months of 1937 does make distribution to its stockholders of its excess earnings—that is, over what it has paid in the regular quarterly dividends in 1936—so as to bring its tax rate below 15 percent, or down to zero—to that extent the Government is a year behind in the collection of its revenues.

Mr. VINSON. The only time they would be a year behind would be if you had 100 percent distribution?

Mr. PETTINGILL. Well, it gets behind pro tanto, anyhow, to the extent that the corporation pays less than the present rate of 15 percent.

Mr. VINSON. Well, pro tanto or eo in statu or a pluribus unum, that would be the only time? [Laughter.]

Mr. PETTINGILL. I shall not attempt to vie with the gentleman in quoting Latin.

Mr. VINSON. If here were 100 percent distribution, the gentleman is correct; you would have no corporate tax for the taxable year 1936.

Mr. PETTINGILL. That is right.

Mr. VINSON. But to whatever extent money went to surplus, you would have a corporate tax for that taxable year.

Mr. PETTINGILL. The gentleman and I do not understand each other. You say that whatever earnings go to surplus—

Mr. VINSON. I mean that is the base; that is the yardstick.

Mr. PETTINGILL. Whatever is withheld is subject to taxation.

Mr. VINSON. Oh, no.

Mr. PETTINGILL. Whatever is not distributed is taxable.

Mr. VINSON. Oh, no. What is retained or withheld is the yardstick which determines the rate that is applied to the adjusted net income.

Mr. PETTINGILL. That is right. The earnings not distributed fixes the rate on the entire net earnings.

Mr. VINSON. And whatever that corporate tax would be, it would be levied and collected for the taxable year 1936.

Mr. PETTINGILL. That is right.

Mr. VINSON. It would only be when you had 100 percent distribution that you would not have the corporate tax for 1936.

Mr. PETTINGILL. I cannot follow that fully. It might be 9 percent or 4 percent or nothing, but less than the present rate of 15 percent.

Mr. VINSON. I am certain that when the gentleman thinks it out he will agree with me.

Mr. MCCORMACK. He agrees with that, but he also says that if they save 15 percent for reserve there will be a loss of revenue.

Mr. PETTINGILL. That is right. It is pro tanto.

Mr. MCCORMACK. In other words, anything less than an average of 30 percent retained for surplus would bring in less—

Mr. PETTINGILL. Then the present tax.

Mr. MCCORMACK. Less next year than it would be under the flat rate!

Mr. PETTINGILL. That is right.

Mr. MCCORMACK. The gentleman's contention is that there is a strong probability of a loss of revenue for at least a year?

Mr. PETTINGILL. That is right.

Mr. VINSON. I think you could draw the inference that there would be some loss. There might be some loss or there might not be. But certainly you would not drop the entire corporate tax out unless you had 100 percent distribution?

Mr. PETTINGILL. Oh, no; I do not mean to say that. I just want to point out the danger that the Government is not going to get the money in the year in which they thought they were going to get it.

Mr. HILL. Of course, the stockholder would have the following year in which to pay his tax on the dividend?

Mr. PETTINGILL. That is correct.

Mr. HILL. But it has not been the practice of corporations to go back and pay out all of their dividends at one particular time. Sometimes they pay them out quarterly and sometimes semiannually.

Mr. PETTINGILL. Yes.

Mr. HILL. Now, there would be no object, so far as the corporation is concerned, in holding back and paying all these dividends after December 31 of any particular year.

Mr. PETTINGILL. Mr. Hill, the dividend that a corporation would normally pay out quarterly to its stockholders in 1936 is not what this bill is getting after. This bill is to force out more than the corporation habitually would pay out, and that certainly cannot be determined until the end of the corporate fiscal year, when it balances its books and determines what its earnings are and how much it shall distribute to its stockholders.

Mr. HILL. The corporation pays out its dividends as it has been doing heretofore, and then it has 2½ months after the taxable year

ends in which to determine what percentage of its net income it has paid out in dividends?

Mr. PETTENGILL. That is right.

Mr. HILL. That is the main object of having this 2½ months time given in which to cast up their accounts and see just how they stand with reference to the dividends in proportion to the net earnings.

Mr. PETTENGILL. But the extraordinary distribution to the stockholders that this bill is designed to encourage will not take place until that 2½-month period, it seems to me.

Mr. HILL. Well, we would have that under the present law. If, for instance, a corporation is paying a 15-percent flat rate now, it might issue some of its dividends in 1937 out of the earnings for 1936. In that case, of course, the stockholder would not be liable for income tax on it until 1938.

Mr. PETTENGILL. That is true.

Mr. HILL. So there is no difference in principle, in that regard, between the present system of taxation and the proposed system.

Mr. PETTENGILL. I will take just 1 minute more to sum up, and to say that the statement that I have prepared indicates my entire sympathy with the idea of taxing corporate surpluses unreasonably withheld, beyond prudent need. But it does seem to me, gentlemen, that we should retain the present flat tax, and then as a surtax upon that, using the first as a foundation, devise some formula to reach the surpluses unreasonably withheld from stockholders.

Mr. TREADWAY. Mr. Pettengill, your prepared statement will be put in the record, will it?

Mr. PETTENGILL. Yes, sir; and I have attempted to work out a formula under which that could be done.

Mr. CROWTHER. I do not know whether you have attempted in your brief to define them, but who is going to describe unreasonable surpluses that are withheld? Would not the variation be so tremendous in the 300,000 corporations that it would be difficult to determine? I know you have thought on that subject, because you are constructive.

Mr. PETTENGILL. I have given this a great deal of thought.

Mr. HILL. I might make the suggestion that in section 351, I think it is, we have set out some standards upon which this is to be determined.

Mr. PETTENGILL. Mr. Crowther, what I thought would be something worthy of study would be to permit the corporation, if its current assets with reference to current liabilities were less than 4 to 1, to build up to 4 to 1 under the present flat tax before what I might call the penalty tax would apply; and then to have two further limitations upon that, namely, that in no year shall be amount subject only to a flat 15-percent tax exceed 10 percent of the net worth of the corporation nor 10 percent of the net sales or 10 percent of the net operating income; using that as a limitation in any one year upon the 4 to 1 ratio between assets and liabilities, which ought not to be taxed more than the present rate.

Mr. CROWTHER. And you describe it advisedly as a penalty tax?

Mr. PETTENGILL. I said that. I prefer to call it a surtax.

The CHAIRMAN. We thank you for your appearance and for the information you have given the committee.

(The statement submitted by Mr. Pettengill is as follows:)

STATEMENT OF HON. SAMUEL H. PETTENGILL, MEMBER OF CONGRESS FROM INDIANA

Mr. Chairman, I approach this problem from the assumption that it is socially and economically desirable to discourage corporations from improperly withholding the distribution of their future earnings.

Nevertheless, I respectfully suggest that the primary responsibility of this committee is to present to the House a new corporation-tax bill which will produce an increase of approximately \$300,000,000 in revenue or, in round figures, \$1,000,000,000, against the estimated production of existing corporation taxes of \$600,000,000 from corporate sources for the fiscal year of 1936. If the major portion of the required revenue from corporations, viz., \$1,000,000,000, is to be raised by or through substantial taxes on undistributed income of corporations, any and all exceptions or qualifications to the imposition of this tax, even such as are contained in the recommendation of the subcommittee, are challenged by the Treasury not on their merit but as they may affect the revenue needed which the bill must produce.

Nevertheless, the exemptions recommended by the subcommittee are meritorious and even further exemptions and qualifications are necessary to prevent the bill from working serious hardship where such is not intended on corporations which cannot or prudently should not distribute all of their future earnings currently in the form of dividends.

Without these exemptions and qualifications the bill becomes unwittingly an instrument whereby the competitive position of large corporations sufficiently well-heeled because of their accumulation of profits withheld from stockholders in prior years is strengthened and, conversely, the competitive position of companies not well-heeled is weakened. I call your attention to the fact that the big companies which I have described as being well-heeled are so, in many instances at least, because in the past they have done the very thing which you are now trying to prevent corporations from doing in the future.

I am sure you agree with the principle that competition in our business structure should be preserved, that we should check rather than further the concentration of economic power in a few hands. It seems to me that there is grave danger that the pending proposal in its present form will have exactly the opposite effect.

Let me illustrate. We have two competitive industrial corporations. On January 1, 1936, one had a substantial reserve accumulated out of profits of prior years. Its ratio of current assets to current liabilities was sufficient for the normal operation of its business and also for those variations therein which might be reasonably anticipated. This corporation might under the proposed law welcome the cancellation of existing corporation taxes which it pays and the substitution therefor of a tax on undistributed earnings because under such a plan the corporation which I have described would, or could, undoubtedly escape all Federal taxation.

On January 1, 1936, the other corporation was not so well-heeled. It had not in prior years withheld profits from its stockholders or is a new enterprise at the threshold of its career. It is not in a position where it can surely pay out all of its future earnings as dividends without jeopardizing its very existence. It is the stockholders and employees of this kind of corporation who will be seriously hurt unless some further modifications are made in the proposed bill.

Suppose that both of the corporations in my example made a profit of \$1,000,000 in 1936. The first one which is well-heeled is in a position to pay out all of that million dollars to its stockholders and to escape Federal income taxation entirely. The second may be in a position where the necessity of retaining its earnings in the business is so pressing that its directors cannot distribute any of such earnings to stockholders regardless of the penalty thereby imposed. Where the well-heeled corporation would pay \$150,000 under the present law and would pay nothing under the proposed law, its less fortunate competitor which would also pay \$150,000 under the present law but would be severely penalized under the proposed law by having to pay an increased tax up to a maximum of \$425,000.

Let us presume that both of these companies sold 42,500 units of their product in the year. By shifting the entire corporate tax burden on the shoulders of the weaker company, where it is now equally borne, the stronger

company would be subsidized to the extent of \$10 per unit and could underpin its weaker competitor by at least this differential. Thus, big business would be given still another advantage over little business. It is not necessary to add to the natural advantages which big business has over little business to accomplish either of the purposes of this bill, namely, to increase the revenue or to discourage improper accumulation. If the unit were a typewriter or refrigerator wholesaler at \$50, the subsidy is 20 percent.

As stated in my opening remarks, Mr. Chairman, I submit that the problem now before your committee is intensified because it is proposed that the new taxes on undistributed income shall raise not only the additional revenue required, but shall also replace or become a substitute for the existing corporate income taxes. Obviously, it is a serious thing from the Government's standpoint to give up the present normal tax on all corporation income, which, I understand, it is estimated will produce more than \$800,000,000 in the fiscal year of 1936. This tax is proven by past experience to be a dependable source of very substantial revenue. I urge that it be retained for this reason, for the additional reason that it will reduce by more than one-half the amount which must be raised by the proposed new tax on undistributed earnings and for the third reason that it will open the way for your committee to write into this bill the reasonable reservations and qualifications which are necessary to make it constructive and in no wise destructive without endangering to anything like the same extent the program of the Treasury as to what this bill must produce in the way of increased revenue.

Accordingly, Mr. Chairman, I propose that your committee consider the following amendments to the recommendations of the subcommittee:

1. That the existing normal tax on corporation income of approximately 15 percent, which, I understand, it is estimated will produce about \$800,000,000 in the fiscal year of 1936, be not repealed.

2. That the schedule of taxes on undistributed income contained in the subcommittee's recommendations be adjusted to take into account the retention of the present corporation income taxes just referred to, after making provisions for the exemptions and qualifications which should be written into the bill.

3. As to these exemptions and qualifications, I suggest the following:

(a) As provided for in paragraph XIX of the subcommittee's recommendations, undistributed income required to replace profit and loss deficits carried over from prior years or to replace nondefensible losses occurring during the current year should be subject only to a base tax, which I suggest should be the existing normal tax of approximately 15 percent.

(b) As provided for in paragraph XX of the subcommittee's recommendations, undistributed income required to meet bona-fide contractual obligations in existence on January 1, 1936, should be subject only to a base tax, which I suggest should be the existing normal tax of approximately 15 percent.

(c) Because the exigencies of future business are bound to result in losses as well as in profits to corporations and because it is their average earnings, not their earnings for a single year without regard to their losses in other years, which determine their ability to distribute earnings to stockholders and which also determine whether or not they are unreasonably withholding earnings from their stockholders, I suggest that undistributed earnings required to replace net losses within the two preceding years should be subject only to the existing normal tax of approximately 15 percent.

(d) The subcommittee has wisely recommended that undistributed income to meet bona-fide contractual obligations in existence on January 1, 1936, should pay only a base tax. This provision in the law would cover situations where corporations are required to anticipate the maturity of debt obligations through sinking fund or other retirement provisions of their debt indentures. But because there are corporations having on January 1, 1936, debt obligations not containing sinking fund or other retirement provisions, which, nevertheless, must, over a period of years, make provision for the retirement of such debts upon maturity, I propose that in such cases corporations be permitted to retain out of future earnings each year a pro-rata amount of their debt obligations which were in existence on January 1, 1936, so that in effect they may amortize against the maturity date thereof the amount of such debt obligations, and that they may retain out of future profits the amounts needed for such amortization subject only to the existing normal corporation income tax of approximately 15 percent. The effect of such a provision in the proposed law will be to place corporation debts, but only those which were in

existence on January 1, 1936, on a basis of equality with respect to taxation, not discriminating in favor of those which have mandatory provisions for anticipating maturity and recognizing that in both cases debts must ultimately be paid out of future earnings.

I call your particular attention to the fact that I am proposing that this exemption should apply only to corporation debts which were in existence on January 1, 1936, and not to debts subsequently incurred. I am assuming that your committee believes that it is a wise policy to discourage rather than encourage corporations from incurring in the future substantial funded debt obligations. I submit that by the same token you should encourage and not discourage corporations to discharge their debt obligations which were in existence at the beginning of the effective period of the proposed act by retirement rather than by refunding.

(e) Mr. Chairman, I have one final proposal which I urge upon your committee for consideration. It has to do with the obvious fact that on January 1, 1936, the effective date from which profits subject to the proposed law will be calculated, all corporations were not on an equal footing with regard to their ability to pay, and ability to pay is recognized as the cardinal element in all of our income-tax legislation. We have so recognized it if we give regard, as your subcommittee has recommended, to profit and loss deficits, to debt and contractual obligations as they existed on this effective date, but these are not the only elements in determining the unequal status of corporations.

I repeat my previous statement that there are many corporations which have been guilty of doing in former years the very thing which you are now trying to prevent in the future through the proposed bill. They have withheld from their stockholders large amounts of their earnings. It follows as a matter of course that at the beginning of this year such corporations, which I have previously described as being well heeled, do not have profit-and-loss deficits, in most cases do not have debt obligations, and in many cases have more working capital than any reasonable requirements of their business, including provisions for emergencies, may demand. In many cases these excesses of working capital are invested in tax-exempt securities; in any event, they are not actively employed in the ordinary business of the corporation and not subject to its business hazards. Nevertheless, it has not been proposed that these earnings reserved out of former years be embraced in the operation of the proposed bill nor am I proposing that they should be. However, I urge upon you to give consideration to the less fortunate corporations who on January 1, 1936, were not well heeled; who, therefore, were not guilty of having done in previous years the very thing which you now propose to prevent; who, instead of having a reasonable or normal working capital for their future business, have an inadequate working capital which must be increased out of future earnings before such corporations can provide a reasonable security to the capital investment of their stockholders and to the employment of their many thousands of employees.

My final suggestion to your committee is that corporations so situated be afforded the following relief: If on January 1, 1936, their ratio of current assets to current liabilities was less than 4 to 1, they should be permitted to retain out of future income the amount by which their current assets were less than four times the amount of their current liabilities and that this specific amount of their future earnings should be subject only to the existing corporation income tax of approximately 15 percent.

Recognizing that, while a ratio of 4 to 1 between current assets and current liabilities is generally accepted as a reasonable yardstick for measuring the ability of a corporation to pay its current obligations and to meet the ordinary requirements of its business, there are some kinds of business where such a ratio is not strictly necessary, I propose that two further limitations be placed upon this exception; the first being that the amount of the exemption proposed may not exceed in any one year 10 percent of the net worth of the corporation at the beginning of that year nor may it exceed 10 percent of the net sales or net operating income of the corporation within that year. As a further safeguard against the improper use of this exception the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, might be authorized to promulgate regulations in respect of the classification of corporations in various industries and lines of business and to determine for each classification a proper ratio of current assets and current liabilities for this purpose. I submit that the limitations proposed, together with the fact that this exemption would apply only to the status of corporations on January 1,

1936, would enable you to afford the proper relief, which I have described, with a minimum opportunity of any substantial abuse thereof.

Mr. Chairman, I respectfully submit that the proposals which I have laid before you are not calculated to impair either of the two important purposes of the proposed legislation. On the contrary, they are calculated to enhance those purposes. It is my belief that these proposals, if written into the bill, will increase the expectancy of revenue to be obtained therefrom, as well as stabilize it, and that through the more just and equitable application of the principle of taxing undistributed corporation profits, the merit in that principle will be more widely recognized and accepted.

The CHAIRMAN. Dr. John H. Gray, representing the Peoples' Lobby, was on the calendar for last week, but was unable to be present. He is here, and requests to be heard for 5 to 10 minutes. If there is no objection, we will call him.

**STATEMENT OF DR. JOHN H. GRAY, WASHINGTON, D. C.,
REPRESENTING PEOPLES' LOBBY**

The CHAIRMAN. Dr. Gray, will you please give the stenographer your name and address and the capacity in which you appear.

Dr. GRAY. John H. Gray, representing the Peoples' Lobby, Washington, D. C.

The CHAIRMAN. You want to discuss the committee report? Your remarks will be within the scope of the report, will they?

Dr. GRAY. I think so, sir. I want to discuss the general principles involved.

The CHAIRMAN. How much time do you think you will need?

Dr. GRAY. I ought to have about 20 minutes.

The CHAIRMAN. Mr. Marsh said you wanted about 5 or 10 minutes. You do not think you can complete your statement in less than 20 minutes?

Dr. GRAY. I do not think so.

The CHAIRMAN. Of course, if it is confined to this report, I do not think the committee will object to hearing you for 20 minutes; but if it is just a discussion of the subject of taxation in the abstract, I do not think we can allow you that much time.

Dr. GRAY. I will do the best I can, sir.

The CHAIRMAN. We will recognize you for 10 minutes and see how we get long. You may proceed.

Dr. GRAY. The first thing I want to call your attention to is that the proposition does not provide for raising the necessary revenue. You will have to have more revenue than is proposed in this bill.

The CHAIRMAN. That will be very pleasing to the minority. They do not want any raised.

Dr. GRAY. There is no question in my mind about that, sir. You have already exceeded the Budget appropriation estimates, and you will have to make many more before this session is through, and many more before the next year.

You must inevitably put the burden on the people that are able to pay it; and the first thing that you ought to provide, sir, is the abolition of the consumption taxes. A consumption tax is equal to a poll tax. If you had a universal poll tax, very few people would pay it, and you would not get any money; and every day that the unemployment increases—and it is increasing, sir—and every day that the pay rolls decrease—and they are decreasing, sir—adds to

the people that are unable to pay any tax; and the consumption taxes now bear on the dole, and the dole is pitifully enough below the decent standard of living, and every day is going to decrease the ability of the people to pay anything on the consumption taxes, and is going to throw more of them into absolute starvation.

I should regret to see any tax bill that did not very greatly decrease the consumption taxes, which, according to your subcommittee's report, amount to more than half the revenue.

In the next place, you ought to bear in mind always that your first duty is to decrease speculation. We have become a nation of speculators, and we want to make money by speculation and not by producing.

You talk about balancing the Budget. I cannot see how any sane man thinks you can balance the Budget. I do not think you ought to try to balance the Budget until more people go to work. You cannot have goods to consume, and you cannot have money to pay taxes, unless you produce, and until our production is very greatly increased it is perfectly futile, in my judgment, to try to balance the Budget.

I want to say something on the general line, and I hope the Chairman will not call me down.

We have heard a great deal about thrift, particularly from the eloquent address of Governor Fort. Now, you cannot teach thrift, gentlemen, when a man can make a million dollars in a day or a week by speculation, whether it is by watering stocks or on the stock exchange. It cannot be done. It is futile to try to do it.

In the next place, gentlemen, you want to use care in the attempt to make some degree of security. The taxes should not increase the insecurity, which is appalling at present.

It is no use to exercise thrift. A man is a fool that will work for 50 years and save as hard as I have when he can be wiped out in one night by speculation, by forces over which he has no control and of which he has no knowledge.

I wish the committee would indulge me for a minute on the danger of excessive cash surpluses.

You all know that the term "surplus" is purely an accounting term. It simply means the excess of the net worth over all the debts, and that includes the stock, of course. That has very little significance on the question of the ability to pay taxes, particularly with the enormous overcapitalization that we have at present.

We have heard a great deal in the last week, particularly from the small packers, in regard to the small corporation. The "small fry", whether individual or corporation, is always at a disadvantage, and if he is running on a shoestring and has excessive debts, he is likely to go to the wall. He has been going to the wall constantly. He will keep on going to the wall until you can tax the great monopolies in some way, and enforce your taxation. The big corporations, 200 of them, control half of our industrial property. If they should keep on at the same rate—of course, they are not going to, or it would lead to revolution—they would own every shred of industrial property in 40 years. There would be so small corporations.

Referring to speculation, I want to say a word about speculation in land.

I am a farmer, by origin, instinct, and training. The farmers say that except at very rare intervals, say a great war or something of that sort, they have never made money in farming. Many of them have become rich by the increase in values of land, and the pioneers took land in the hope that they would dig a living, however meager, out of it, and sit there until the land should increase and they would become wealthy. And the farmers are themselves great speculators.

I made some special investigation a few years ago on the speculation in farmlands in Iowa, and I found that farmlands had sold there, where there was no hope of using them for anything but farming, for as high as \$600 an acre. I found large farms there that were mortgaged for \$450 an acre. Now, any sane man knows that you can never, in any time that can be foreseen, make an income to pay that out of farming. It can be done on small tracts, such as truck farms, but it cannot be done on farmland such as Iowa has.

Mr. KNETSON. They could make money on that land if they were paid for not producing?

Dr. GRAY. Yes, sir; but that is not making much progress. That is not the road to progress or safety.

Mr. KNETSON. If, for instance, a man obligated himself not to raise 50,000 hogs on 160 acres, at \$10 a hog?

Dr. GRAY. That is not the way to find peace, prosperity, or happiness. Talk about overproduction, when there are thousands and millions of people at home suffering for the need of the products of the farm. To talk about overproduction is nonsense. There is overproduction only when you cannot sell for a profit, and that is very easily arranged.

In regard to the land, the farmers, of course, are in debt more than they can ever pay. We might just as well fact that fact. The whole country is in debt more than it can pay. I am not so much alarmed about the Federal debt as I am about the corporation debt and the farm debt.

Now, there is a grave misapprehension about that, gentlemen. We talk about thrift, and we have a tradition that debts ought to be paid. Debts, public or private, have never been paid. While the units were small, you closed them up through the bankruptcy courts. It was hard on the creditor; he did not get his full pay. It was doubly hard on the debtor, but as long as there were undeveloped and unappropriated resources he could go out and begin again. Now, the units have become so big, and credit so unsettled, that you cannot afford to let a great corporation fail. It checks the whole thing.

I have in mind the Dawes loan. I know the history of that loan, from both ends of the transaction. Dawes did not ask for that loan. He did not want it. He had failed, and he knew he had failed. He had made all the arrangements to close his bank. He believed that he could pay out if given time, but he was ready to close his bank. That loan was forced on him by the President of the United States, and it was probably lost in very large part.

Public debts have never been paid. They are just repudiated. You cannot do that with the credit we have; you cannot do it with the units we have. The debts of this country will never be paid. The only reason that most of the property has not passed to the

mortgagees, sir, is that the creditors could not afford to take it. They did not want to pay the upkeep and the taxes. All the mortgage companies and most of the insurance companies would have been absolutely bankrupt if they had tried to foreclose their mortgages. The leading bankers of Des Moines, after a little episode that we had in 1921, uniformly told me—I made some special investigations there—that if they tried to foreclose all the mortgages that were overdue or in default on principal or interest, there was not a bank on the soil of Iowa that would not close its doors in an hour. They were absolutely locked up.

Now, in writing your tax bill you have got to look after these things. They are fundamental.

The first thing is to get the revenue; the second thing is to distribute the burden where it is bearable; the next thing is to levy the taxes where you can collect them.

Now, I want to recommend that you levy an excise duty on the right to own land. I would start with 1 percent. I would start gently. That is a social value. I am not what they call a single taxer. I have fought against single taxes. But that speculation has led us into this, and it is just as important as speculation on the stock exchange.

The CHAIRMAN. Do you apply that to the present owners of the land or to the future owners? You say that the present owners are already in debt so heavily that they can never pay out. If you put another tax on them, how will that help?

Dr. GRAY. That is because they have inflated the value of their land, Mr. Chairman.

The CHAIRMAN. But that is the situation, no matter what causes it?

Dr. GRAY. Oh, that is the situation.

The CHAIRMAN. Then do you propose to put this tax on the present owners or the future owners?

Dr. GRAY. The present owners, sir.

The CHAIRMAN. But you say they are already hopelessly in debt?

Dr. GRAY. Yes, sir.

The CHAIRMAN. And the only reason they are holding the land is because their creditors do not want to take it?

Dr. GRAY. Absolutely.

The CHAIRMAN. And now you would put an additional tax on it?

Dr. GRAY. Yes, sir. I would lower the value. I would do it as a means of lowering the value.

The CHAIRMAN. I just wanted to get your position.

Dr. GRAY. I answer "yes, sir."

Mr. KNETSON. It is your purpose, then, to put the farmer out of his misery by putting more taxes on him?

Dr. GRAY. No; I should not say that, sir. I do not accept that.

If I had time, Mr. Chairman, I would like to show you the danger of a great cash surplus.

The CHAIRMAN. That is what I wish you were going to do. That would come within the scope of this bill—cash surpluses.

Dr. GRAY. You propose to tax future cash surpluses—future surpluses, not past. I think, if you knew as much as I do, sir, about the evils of a great cash surplus, you would change your mind.

The CHAIRMAN. I have not said what my mind is on the subject. Dr. GRAY. I am talking to the whole committee.

I want to say a word about the cash surplus, having defined "surplus" in general as an accounting term.

When the war closed, Europe was literally devastated—men and soil and equipment. She had endless needs and no purchasing power. Our bankers conceived the idea of floating foreign bonds in this country, and they peddled them from house to house. I suppose in 1920, as poor as I am, there was not a week that a bond salesman did not ring my doorbell. Now, when they sold the bonds, they sold them to the small fry. They got their commission on the loans. Every dollar of those loans was spent in this country. Germany spent \$1.84 for every dollar she borrowed from the United States during that period, in the United States. Profits increased enormously—profits of manufacturing. They required enormous funds to enlarge their factories. The bankers got a rake-off on their bonds and stocks. They required large current bank loans to carry their invoices, and so on. The bankers got a rake-off on that, and the corporations became very luxurious. First they paid extra dividends to be safe; then they increased their dividends; and then they got so much surplus that they did not know what to do with it, and then they began to loan it on call loans on the New York Stock Market; and when the crash came, about half the call loans, namely, four and one-half billions, were outside of bank money. You know what the Wall Street gang calls that. They call it "bootleg money", because the banker thinks he is entitled to a rake-off on every transaction.

Now, they ran their stock up, the City Bank, the largest in the world, to more than 50 times what it has sold for since. They ran it up to more than 20 times what it is selling for today and they loaned about 2½ million dollars to their own directors to speculate with in their own stock. That is the evil, and that was primarily responsible—the speculation—for the crash. They kept that up until they ran the interest rate up to 20 percent on call loans, the safest security in the world.

I would like to tell a little story about that, in about two sentences. I had some friends that I had not seen for a long time. They had formed a new mortgage company and got about 2 or 3 million dollars paid in cash capital. That was in 1928. I was passing their door and I thought I would go in. I went in and I said, "Hello, John, how are you getting along in the mortgage business?" He said, "Mortgage, hell. We cannot do any mortgage business." I said, "You got your stock paid in, did you not?" He said, "Yes we got it paid in, but we are getting an interest rate on the average of 12 percent on call loans in New York the last year, and we sent it over to Wall Street and we are going to leave it there until the crash."

You cannot have that sort of accumulation of money by men who have gotten it together to make profits and profits only. The time comes when they cannot make the profits.

In the last 6 years there has been the greatest acceleration of the concentration of wealth the world has ever seen, with the exception of paper inflation. Those fellows control all the cash. They cannot invest it now in the natural resources of the world, which have been

gobbled up by the big nations and are apportioned out. The strife between imperial nations has gotten to the point where they cannot invest it abroad, they cannot send it abroad. There are no safe loans to make abroad today.

When this country was undeveloped and there were resources here undeveloped, they could invest it here and make a profit. But they are overinvested now. It is all locked up in 2 or 3 billion dollars of extra legal reserve and it is being loaned to the United States at one-twentieth of 1 percent, or thereabouts.

I made some investigation of the rate that the Government is paying on its short terms. I find that in 1 year they had issued \$3,500,000,000 in short terms and they had not paid as high as three-tenths of 1 percent. A very large part of it went at five one-hundredths or seven one-hundredths of 1 percent.

A large part of that, a very large part of it, has been paid out in unearned dividends. The latest reports show that there has been paid in the last 6 years, since the depression, about 27 billion dollars that they have not earned. Part of that has gone into expenses, of course. A part of it has simply been dividends paid out of surplus.

The distinction between taxing past surpluses and present surpluses is purely a fictitious one. You ought to tax where the money is. You ought to tax where it can be collected, and you ought to get out machinery for collecting it.

Unless there are some further questions, I do not care to detain the committee any longer, considering the rush it is in.

The CHAIRMAN. If there are no questions, we thank you for your appearance, Mr. Gray.

Dr. GRAY. If you will allow me one additional remark. I would say, sir, that my suggestion would be to lower the base of the income tax. There ought to be an increase of tax on every income above \$5,000 and you ought to increase very largely the taxes in the higher brackets.

There is one other item, if the committee will indulge me for a moment. We used to say that it took three generations from shirt sleeves to shirt sleeves. That was true in the pioneer days, but it is not true today. I have followed very closely, for 40 years, the disposition made of very large fortunes and I know of but one large fortune—and that is that of Julius Rosenwald, that has not been tied up for family use for from 75 to 105 years. If you would put a very heavy tax on family trusts you would strike at the very heart of the problem and you would get a lot of revenue.

I thank you.

The CHAIRMAN. We thank you for the information you have given the committee, Dr. Gray.

Mr. MARSH. Mr. Chairman, may I make this request of the committee, to file a brief statement of the revenue situation, for the record, on behalf of The Peoples Lobby, in addition to Mr. Gray's statement? It is only about 1,200 words, with some figures.

Mr. COOPER. Mr. Chairman, I do not think we ought to burden the record with all these statements.

The CHAIRMAN. A lot of these statements have been submitted to the committee for the record. I think we had better wait for the committee to pass on whether they should be put in the record or not. The committee will decide whether it is wise to put that in the record.

Mr. COOPER. I understood it was a printed pamphlet.

Mr. MARSH. It is only a 1,200-word article.

Mr. COOPER. May I suggest that the matter be submitted to the chairman and it be in his discretion whether it be made a part of the record or not.

The CHAIRMAN. We have a great deal of data that has been submitted on which we have not passed as yet.

Mr. MARSH. We do not regard it as a revenue bill, but we want to point out how to help balance the Budget before we go too far amuck.

The CHAIRMAN. The committee will decide whether to put that article in the record.

The committee will now take a recess until 2 o'clock.

(Whereupon a recess was taken until 2 p. m.)

AFTERNOON SESSION

The recess having expired, the committee reconvened at 2 p. m., Hon. Robert L. Doughton (chairman) presiding.

The CHAIRMAN. The committee will be in order. The next witness is Arthur H. Kent, acting general counsel of the Bureau of Internal Revenue.

STATEMENT OF ARTHUR H. KENT, ACTING CHIEF COUNSEL, BUREAU OF INTERNAL REVENUE

The CHAIRMAN. Do you desire to make your statement without interruption?

Mr. KENT. I should like to, Mr. Chairman.

The CHAIRMAN. You may proceed.

Mr. KENT. It is my purpose to consider briefly a few of the criticisms of the proposed tax legislation, as outlined in the report of your subcommittee which have been made by witnesses during the interesting hearings of the past week.

Before passing to the proposed change in the basis of taxation of income from corporate enterprise, to which the major portion of my remarks will be directed, I should like, with your indulgence, to make a few observations with respect to the so-called windfall tax. It is my conviction that both the objective and the underlying principle of this tax are just and equitable. The hearings have demonstrated considerable misapprehension as to its scope and intent. It cannot be too often reiterated that the base of this tax is that portion of the net income derived from transactions in commodities, which is attributable to the amount of processing tax passed on by a taxpayer to his customers which he has failed to pay over into the Federal Treasury. If the result of the taxpayer's transactions in such commodities during the period to which the tax may apply is a net loss, the basis for tax purposes will be zero and no tax will be due, since by definition the proposed tax is one upon a particular kind of net income and is in no sense a retroactive excise tax. It is believed that, as between such a taxpayer and the Federal Government, the latter clearly has the superior claim, in view of the practical impossibility of restoring directly to individual consumers who bore the burden of the tax in the prices they paid the amount of such

tax. They will at least share in the benefits of the restoration of a substantial portion of the amount of such unpaid tax to the Treasury.

The difficulties of the proposed "windfall tax" are not those of principle but rather the usual practical difficulties of drafting a law prescribing standards and methods of proof which will be capable of administration and at the same time will operate with reasonable equity to the taxpayers affected. The problems of administration are essentially problems of fact determination. There is no disposition to minimize their difficulty but it is believed that their solution is no more difficult than many other problems with which the Bureau of Internal Revenue has been called upon to deal. In disputed cases which will not yield to the processes of administrative settlement, taxpayers will enjoy the protection of the usual judicial review of the Commissioner's determinations.

In his tax message, the President pointed out that the accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. The President further stated that [reading]—

Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the tax, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends; while the shares of stockholders who can afford to leave earnings undistributed escape surtaxes altogether.

It is the principal object of the proposed legislation, as stated by Commissioner Helvering at the opening of these hearings, to raise the major portion of the additional revenue required through the elimination of the condition adverted to by the President. One of the principal objections urged by witnesses appearing in opposition to the plan of a tax upon the adjusted net income of corporations with a rate graduated upon the basis of the percentage of such income not distributed is that such a tax will prevent corporation management from accumulating reserves for a rainy day or for purposes of plant and business expansion. The answer to this objection is that such is not the intended nor the necessary result of the proposed measure. The fact is continually overlooked that the measure will permit retention of a substantial fraction, somewhat larger, it is true, in the case of small net income corporations covered by table I than the larger ones covered by table II, without a corporate tax burden equal to or in excess of the burden imposed by the present law. In other words, corporate management remains free to make its decisions with respect to the distribution of its earnings, subject only to the qualification that such decisions shall not in general operate to impair a source of necessary revenue of the United States.

Corporations may, within a period of 3 or 4 years, accumulate earnings equal to or in excess of the entire net income for a single taxable year without increasing the amount of their taxes over the amount now paid. The proposed plan appears in a still more favorable light in this regard as compared with the situation which would exist were a major portion of additional revenue needed to be secured by raising the present corporate rate to a figure approximating 20

percent, as has been suggested. It is not perceived wherein such a new basis of corporate taxation is destructive of reasonably adequate provision for a rainy day.

If particular corporations need a larger sum for proper plant enlargement and business expansion than the retention of 30 or 40 percent of their net earnings will provide, there are several other means available by which the additional capital required may be obtained. I refer to the sale of stock rights, or the retention of cash in the business by the use of taxable stock dividends or the issue of interest-bearing dividend script to shareholders. Under any of these alternative methods the equitable owners of the business enterprise, namely the shareholders, provide the needed capital after payment to the Government of their individual taxes, just as they would have to do under similar conditions were they conducting the business as individuals or in the partnership form, or if a new corporation was organized.

It has been strenuously urged that special treatment should be given to that portion of corporate net earnings used or set aside to liquidate corporate indebtedness, similar to the treatment suggested by the subcommittee in these cases covered by section 20 of its report. It is assumed that such treatment would in any event be limited to indebtedness incurred on or before a specified date. A consideration of the merit of this suggestion requires some analysis of the purposes for which such corporate indebtedness was incurred. Such purposes may be classified into three groups: (1) Short-term borrowings to finance the production of goods and services; (2) borrowing (normally for a longer term) to finance the acquisition of property and facilities and the enlargement of existing facilities used in a business for production of income; (3) borrowing for the acquisition of non-income-producing and nondepreciable property.

With respect to borrowing of the first type, it is not seen wherein special treatment would be either necessary or desirable. The corporation has resorted to a bank or some other lending agency for funds to increase temporarily its working capital. When the corporation's goods or services are sold in the market, the proceeds of the sale represent a recoupment of the cost of goods sold and the profits from the sale. Since the cost of the goods sold was financed by current borrowing, the recoupment of that cost from such proceeds provides the fund out of which the loan can be met. The profit on the sale becomes a part of the net income to be distributed or retained as the corporation management may determine. Such profit strengthens the credit position of the corporation and enables it the more easily to renew its loans or to secure new loans to finance its operations for the succeeding year. A demand for special treatment of such indebtedness would, therefore, simply mean that the corporation would be seeking at the expense of the revenues to build up its working capital to the point where it could dispense with bank borrowing to meet its needs for current capital.

If the existing indebtedness represents borrowing of the second type, that is, for capital investment in income-producing property, your attention is called to the fact that it is with respect to such property that liberal provision is made under existing law by way of allowable deductions for reserves for depreciation, obsolescence, and depletion for the amortization of the capital investment. Corpora-

tions which have followed the conservative policy of funding such reserves are unlikely to find themselves embarrassed in meeting such obligations at their maturity. If a corporation has not funded its reserves or has dissipated its reserve funds for purposes of dividend payments, exorbitant executive salaries, or in other ways, a question may properly be raised whether they should be given special consideration thus discriminating against conservatively managed companies, at the risk of substantial loss to the revenue or whether the corporate management should not be left to solve their problem in other possible ways. Various methods by which this may be done have been referred to above.

Borrowing of the third type would ordinarily be for speculative purposes and to that extent would involve a departure from sound and prudent principles of corporate management. If the speculation has proved unfortunate and the property cannot be liquidated for an amount sufficient to discharge the obligation incurred in order to acquire it, the corporation has sustained a capital loss which may be offset against capital gains in determining the corporate net income. There seems to be no persuasive argument of policy for extending special treatment to a corporation at the expense of the revenue in order to enable it more easily to meet the capital net loss which it may have sustained.

So far as it has been suggested corporations may have to borrow to pay this tax, there will be no greater likelihood or necessity of this under the new than under existing law. The tax is levied upon income earned during the taxable year and is received in cash or in property valued in terms of the cash it will bring. A properly managed corporation will have made proper provision for this as for any other tax. It is the cash position, not the book surplus, of a corporation which is important.

Every exception and each new form of special treatment of particular types of corporate situations will tend to complicate the administration of the new corporate tax, if enacted into law, and will impair the uniformity and equality of its application, as well as endanger to some extent the estimates of the revenues to be obtained or necessitate higher rates upon those not favored. It is believed, for these reasons as well as others to which I shall advert presently, that the number of exceptions and cases of special treatment provided for should be kept down to the minimum which sound policy or impelling practical necessity may require. Reflection will show that the problem of the debt-ridden corporation is not fundamentally different from that of the debt-ridden business enterprise carried on in the individual or partnership form. An individual or a partnership must pass his or its income through the tax mill before the residue can be applied to the liquidation of debt.

Equality of treatment would seem to demand that the shareholders as the beneficial owners should be expected to do likewise, particularly since the liquidation of corporate indebtedness tends to increase pro tanto the value of their equities in the corporate enterprise which is encumbered by the amount of the debt. The problem of the corporation is simply the problem of having on hand the amount of cash required to meet its obligations. Assuming that it has not by means of sinking funds or other reserves made proper advance provision to do so, at least three alternative meth-

ods, other than refunding or new borrowing, by which it may mobilize the necessary cash for this purpose have already been pointed out. It may be observed, also, in passing, that the possible inequalities in the tax on individual shareholders which it has been apprehended might result from the proposed tax as between the shareholders of corporations having equal income but not similarly situated with respect to indebtedness or the need of money for plant replacement or extension may be avoided by resort to one or another of these devices for keeping needed cash in the corporate treasury.

One of the major underlying principles and objectives of the proposed measure is the reduction to the lowest possible minimum of the inequalities of the present law as it applies to different types of business enterprise. It would be a mistake to depreciate the importance of the individual or partnership form of the business unit in our economy. Even under existing law individual and partnership business enterprises outnumber business corporations by about 2½ to 1. The figures read into the record by Commissioner Helvering several days ago showed a total of partnership returns filed for 1935 of 205,432 showing a total net income of \$1,072,264,889.30. This total number included 26,180 returns showing losses of \$87,012,154.46 and 179,252 taxable returns showing a total net income of \$1,159,277,043.76. Fifty-seven of these partnerships show net income of \$500,000 to \$1,000,000 and 23 net incomes of over \$1,000,000. This total net income for partnerships compares with an estimated total net income for corporations for the same period of 5½ billion dollars. While it must be admitted that corporations have some disadvantages as well as certain advantages, as compared with the partnership form of business unit, it seems perfectly clear that on the whole the present tax system unduly favors the corporation. The following figures show the number of forms 1065 (partnership returns) and forms 1120 (corporation returns) filed each year from 1921 to 1935, inclusive.

Mr. Chairman, I do not suppose it is necessary to read that, but wish to insert it at this point. However, I wish to point out that the maximum number of partnership returns which are, of course, information returns, was made in 1924 and has dropped quite steadily since that date.

(The matter referred to is as follows:)

Year	Number filed (1065)	Corporations (1120)	Year	Number filed (1065)	Corporations (1120)
1921	228,443	361,459	1929	272,127	516,194
1922	282,554	486,765	1930	263,519	538,160
1923	312,813	459,692	1931	244,670	527,829
1924	326,553	427,089	1932	231,407	526,978
1925	191,109	639,913	1933	216,712	525,017
1926	169,444	470,022	1934	214,891	524,791
1927	280,121	174,371	1935	221,710	534,680
1928	282,641	196,273			

Mr. KENT. It will be noted that partnership returns filed in 1935 decreased 106,813 as compared with 1924, whereas corporations filed in 1935 increased 131,596 as compared with 1924. While it is not intended to imply that the decrease in the number of partnerships

is to be wholly accounted for by incorporation, it does seem safe to assume that a very considerable portion of the corporate increase is represented by an incorporation of what were formerly partnerships. Businessmen may well be left free to choose between the individual or partnership form on the one hand and the corporate form on the other on the basis of their inherent advantages and disadvantages for business purposes, without regard to tax considerations. I also wish to introduce into the record a table which gives a comparison of total tax liability from income derived from unincorporated businesses and from dividends under various assumptions representing distributions of earnings and profits of equal partners and stockholders, for a single individual with no other income.

(The table above referred to is as follows:)

Comparison of total tax liability for incomes derived from unincorporated businesses, and from dividends, under various assumptions respecting distribution of earnings and number of equal partners and stockholders, for a single individual with no other income

TOTAL TAX LIABILITY AS PERCENT OF INCOME RECEIVED*

Form of business	Net income						
	\$1,000,000	\$500,000	\$100,000	\$50,000	\$25,000	\$10,000	\$5,000
Individual	18.02	61.04	32.25	18.67	11.23	5.60	3.40
Partnership:							
2 parties	31.04	31.71	18.67	11.22	6.52	2.80	1.60
4 parties	51.71	30.36	11.22	8.32	3.75	2.00	.40
8 parties	84.17	33.35	9.17	5.60	2.60	1.50	0
16 parties	32.60	22.22	6.52	3.70	2.32	.80	0
Corporation (no earnings distributed)	14.94	14.59	14.44	13.88	13.36	12.90	12.50
Corporation (50 percent of earnings distributed):							
4 stockholders	26.18	21.59	16.67	14.00	13.44	12.90	12.80
8 stockholders	25.69	20.39	15.23	13.58	13.30	12.90	12.80
16 stockholders	21.64	18.36	14.55	13.88	13.36	12.90	12.80
32 stockholders	20.43	17.40	14.44	13.88	13.36	12.90	12.80
Corporation (75 percent of earnings distributed):							
4 stockholders	40.58	29.95	17.22	14.95	13.36	12.90	12.80
8 stockholders	37.65	26.87	16.05	14.40	13.36	12.90	12.80
16 stockholders	29.99	21.60	15.49	13.88	13.36	12.90	12.80
32 stockholders	26.91	21.24	15.01	13.88	13.36	12.90	12.80
64 stockholders	21.28	17.63	14.44	13.88	13.36	12.90	12.80
Corporation (100 percent of earnings distributed):							
4 stockholders	53.43	41.38	19.71	16.17	13.63	12.90	12.80
8 stockholders	39.15	36.39	18.40	15.49	13.36	12.90	12.80
16 stockholders	41.41	28.30	16.89	14.12	13.36	12.90	12.80
32 stockholders	36.41	25.87	16.02	13.88	13.36	12.90	12.80
64 stockholders	25.22	20.05	14.44	13.88	13.36	12.90	12.80

* Corporation income taxes are included in the computation of the total tax liability. Not included, however, is any potential individual income tax liability which might arise if and when withheld earnings were distributed.

Mr. KENT. The suggestion has been made that the enactment of the proposed new tax into law will greatly accentuate transfers of stock into tax-exempt securities by individuals falling into high surtax brackets. While it is quite possible that this may occur in some individual cases, it is not believed that the revenue effect in the aggregate will be very substantial. Large as the volume of these securities now outstanding is, such supply is nevertheless limited. A very large influx of funds into the buying market would quickly

reflect itself in a substantial increase in the market prices of such securities now outstanding and a reduction in the interest rates on new issues. Moreover, the securities now outstanding are owned by someone and a withdrawal of funds from productive enterprise by some individuals in order to purchase these securities would mean a like increase in the funds in the hands of the sellers thereof available for other investment. Although it is difficult to evaluate with exactitude the effect of all these variable factors, it seems unlikely that tax-exempt securities will provide an avenue of tax escape substantially wider under the proposed new law than under the existing law.

This tax will not drive stockholders into tax-exempt bonds because:

1. The Federal Government is not issuing any bonds exempt from surtaxes. It does issue short-term bills and notes so exempt, but the bulk of these are purchased by banking and other corporations not subject to surtaxes; and they are issued at extremely low rates of interest—about one-eighth of 1 percent in the case of bills and about one and one-half to one and five-eighths percent in the case of 5-year notes.

2. States and their subdivisions have entered a declining phase of their debt cycle. The prospect is that the aggregate volume of the State and municipal debt will decline rather than increase over the next decade or two. Such a prospect is in line with past cycles of State and municipal debt. Many of these governmental subdivisions have reached the limit of their statutory, charter, or constitutional power to create debt. In most other governmental units, the volume of bond-financed improvements during the twenties was also great enough to arouse taxpayer resistance to any further substantial increase in debt charges.

3. Hence, the supply of tax-exempt securities is unlikely to increase at any substantial rate in the near term future.

Mr. CROWTHER. If I may ask you this question, they are being issued, I understand from pretty good authority, at about a billion dollars a year now.

Mr. KENT. Yes.

Mr. CROWTHER. That is a pretty substantial sum.

Mr. KENT. That is a substantial sum. I am speaking entirely in terms of probable tendencies and do not mean to assert that the amount issued, of course, will not itself be substantial.

Mr. WOODRUFF. On that one point, before you leave it, have you given any thought to the increased amount of tax-exempt bonds that may and probably will be issued by the States and political subdivisions thereof because of the fact that at this time under the P. W. A. and W. P. A. we are extending loans all over the United States to these States and these political subdivisions in order that they may build some public works?

Mr. KENT. Yes.

Mr. WOODRUFF. Now, in order to do that, they certainly have not the cash on hand and they have to go into the market and borrow the money to meet that situation.

Mr. KENT. That is true. Of course, some of them have been unable to take advantage of public-works opportunities because of the fact that they have already reached the legal limit of their indebtedness.

Mr. WOODRUFF. I understand, but to my personal attention has come a number of instances where the Federal Government makes a contribution toward a piece of work and where the State or the political subdivision thereof has gone into the market and borrowed money on tax-exempt securities.

Mr. KENT. Yes.

Mr. WOODRUFF. And it would seem to me that the issuance of securities of this kind would be very materially stepped up by the program now being carried out by this Government.

Mr. KENT. I suppose it will have that tendency—

Mr. VINSON. I think it is fair to say—

Mr. WOODRUFF. Let him answer my question.

Mr. KENT. I suppose it will have that tendency while the Public Works projects continue in the instances of those local governments which are in position to take advantage of it. But when I spoke of entering into a declining cycle I was not speaking of 1 year or 2 years, I was thinking in terms of a 10- or 15-year period, and it certainly is true that so many of the local governments of the country have either reached or are approaching the constitutional or statutory limitation upon their indebtedness, that they are going to find it increasingly difficult to issue tax-exempt securities in the volume that they have been doing for a number of years past.

That is aggravated, I may say, also by the fact that in many places these limitations are expressed in terms of percentages of the total assessed valuation within the territorial area of the respective governments and there has been, of course, a marked decline in such assessed valuations, greater in some places than in others. In Chicago, Cook County, for instance, according to the latest information that I have, it is about 40 percent.

Mr. VINSON. Will the gentleman yield to me on that point?

Mr. KENT. I shall be glad to in a moment. Your conclusions are reached, I suppose, because you see an end to this Public Works construction under the methods now invoked by the Federal Government?

Mr. KENT. I am not really in a position to express an opinion of much value on that question. To the extent that these expenditures or the volume of these expenditures is influenced by the existence of an emergency, I should assume that with an improvement in conditions, the volume of such expenditures would at least decrease.

Mr. WOODRUFF. The best information we have is that there is as much unemployment today as there was 3 years ago, and so far as Congress has been able to determine, so far as there are present expenditures of money for these purposes and proposed expenditures, the emergency has not been relieved to any great extent. Is that your opinion?

Mr. KENT. Certainly the figure with respect to unemployment has not diminished as much as all of us would like to see. I am not prepared to say that I am convinced there has not been some improvement.

Mr. WOODRUFF. They are still very impressive, however, you will say that. And I think you will agree, too, if you have observed the reports not only of the departments of the Government but other well-informed agencies, that so far as unemployment itself is concerned, it has not been reduced in the last 3 years. Is not that sub-

stantially because the authorities seem to agree that the unemployment existing in the country today is approximately what it was 3 years ago?

The CHAIRMAN. What authorities agree on that, I would like to know?

Mr. WOODRUFF. Among the fine authorities, at least that I consider an authority, is the American Federation of Labor.

The CHAIRMAN. That does not mean there is any agreement. One body takes a position, but that is only the position of that one body.

Mr. WOODRUFF. But it is confirmed, I will say, by the statistics published by the Government itself. They confirm that there has not been any substantial reduction in unemployment in the last 2 years.

The CHAIRMAN. Every industry in this country, practically, is running on full time and turning out a much greater output than it was 3 years ago. The textile industry, the automobile industry, the furniture industry—there is not an industry in this country that is not working more people than they were 3 years ago.

Mr. WOODRUFF. But the chairman overlooks the fact that coming into the ranks of the unemployed constantly are the youngsters.

The CHAIRMAN. There are a few coming on; yes.

Mr. WOODRUFF. I know that you will agree that the population is increasing each year.

The CHAIRMAN. I presume it is.

Mr. WOODRUFF. Then the youngsters are largely responsible for that condition, are they not? As a matter of fact, Mr. Chairman, I regret very much that employment conditions have not improved vastly over what they were 3 years ago, but the statistics show that they have not.

The CHAIRMAN. I would disagree with that.

Mr. WOODRUFF. I would be very glad if the chairman would put to the record reports from Government departments that would show that I am wrong about this matter.

Mr. VINSON. The trouble about drawing a balance between unemployment today and those who were unemployed, say, on March 4, 1933, is that our friends did not leave the figures on March 4, 1933. It may be that those estimates, that they took with them, were a little lower than the situation that actually obtained. But anyhow, I think it is fair to say that the question of unemployment is somewhat analogous to the question of prosperity; it is more or less an individual's observation and his knowledge of conditions within his observation. I have not been in Detroit, but I have been reading that in Detroit, which is in the gentleman's own State, they are turning out thousands and tens of thousands more automobiles now than they were back during the Hoover cycle.

I just cannot conceive anyone who is as fine and as fair and as splendid as my good friend from Michigan not knowing that there are more people actually at work today, regardless what the figures may be, that there are more people earning meat and bread today and taking a pay check home, that there are more people in that category now than there were on March 4, 1933.

Mr. WOODRUFF. Will the gentleman permit me to continue this?

Mr. VINSON. Yes.

Mr. WOODRUFF. The gentleman from Michigan said nothing whatsoever about the number of employed. He was speaking of the unemployed.

Mr. VINSON. I am speaking of them, too.

Mr. WOODRUFF. And I want to say to you, Mr. Chairman, that I am perfectly willing to let the reports of the present administration itself either confirm what I have said or confound me. And if the chairman thinks I am wrong about it, I will ask that he get the reports from the departments, the proper departments, and put them in the record.

I hope I am always fair; at least I try to be. But it is a matter of regret to me—I am not saying this to embarrass anyone—but it is a matter of regret to me that there are as many unemployed today as there were 3 years ago. I think every good citizen of this country feels as I do about it.

The CHAIRMAN. There is a great difference between various conditions of unemployment. A great many of the people are registered as unemployed today because they work half of the time and under better business conditions they are willing to take a vacation the other half of the time. Everybody knows that that is true. There are a lot of people who work only when they need to work. They are good people, but if they can earn enough in 20 days to support themselves and their families for 30 days, that is all they want to do. And that is all right. There is a big difference between that and total unemployment. That accounts for a great many of them. They do not want, they do not seek, and they do not need steady work.

Mr. KNUTSON. Will the gentleman yield to me?

Mr. WOODRUFF. In order to establish my fairness—

The CHAIRMAN. That is conceded.

Mr. WOODRUFF. I am willing to let my case rest upon the official figures of the present administration as published.

Mr. VINSON. Will the gentleman yield to me on the question of the bill, in regard to the amount of non-Federal bonds that may be issued to prosecute the P. W. A. projects? I think you would agree with me that the sum total of such State or local bonds would not be wholly in excess of the State and local bonds that would have been issued had there been no P. W. A. program.

Mr. KENT. I think that is unquestionably correct.

Mr. VINSON. While I am not certain as to the amount, my recollection is that in the year 1935, so far as P. W. A. funds that were allocated is concerned, back in my mind is the thought that the figure at one time was \$200,000,000 and possibly something in addition to that. I would like to have you put in the record the amount of P. W. A. funds that were allocated for expenditure in 1935.

Mr. KENT. I will be glad to obtain that figure and put it in the record.

Mr. WOODRUFF. Are you speaking now of P. W. A. or W. P. A.?

Mr. VINSON. P. W. A. projects are those where you had the State, county, and municipality matching Federal money. Of course, it was a long time ago when my friend got off on this political dis-

cession, and we were talking about these State and municipal bonds in connection with the Public Works Administration. I will forgive my friend for forgetting that.

Mr. WOODRUFF. Will not my friend agree with me on this, that if it had not been for the contributions through the P. W. A., there would probably have been very few, if any, tax-exempt securities issued during the last 3 or 4 years?

Mr. VINSON. I would not agree with my friend on that.

Mr. WOODRUFF. There would have been mighty few, because I know of no States or subdivisions of States that have been in a position where they would even think of accepting or shouldering the entire cost of any public works at this time because of the difficulty of getting any revenue whatsoever.

Mr. VINSON. Those localities, those subdivisions of Government, whether they are city, county, or State, if they have legal inhibitions, they cannot issue bonds to secure P. W. A. projects.

Mr. WOODRUFF. I am well aware of that.

Mr. KNOTSON. Would you mind, Mr. Kent, turning to page 10 of your statement?

Mr. KENT. May I finish my statement? I have only a short paragraph or two left.

The CHAIRMAN. Let the witness finish his statement, and he will yield to you, Mr. Knutson.

Mr. KENT. Those who seek tax-exempt securities will be forced, for the most part, to compete with present owners of tax-exempts for the existing supplies.

This will tend, as already stated, to drive up the prices of such securities, to decrease their yields, and to this extent, to neutralize their attractiveness.

4. In practice, moreover, it is exceedingly improbable that any great number of large stockholders would find it profitable to liquidate important or controlling interests in corporations, with all the perquisites in the way of salaries and the like which go with such control, in order to take refuge in tax-exempts.

Such stockholders, in most cases, would face the necessity of paying very large capital gains taxes on the stocks that they might liquidate.

Mr. KNOTSON. Mr. Kent, if you will kindly turn back to page 10, you say there that the supply of outstanding tax-exempt securities is limited. That situation is being corrected rapidly, is it not?

Mr. KENT. I should rather answer that question by saying that there has been a considerable increase in the volume but, however large the volume may be, it is still limited. If the volume increases more rapidly than the national wealth why, of course, it becomes more serious.

Mr. KNOTSON. Is it not a fact that the banks are virtually being compelled to absorb these bond issues that are being put out by the Government?

Mr. KENT. I am not in a position to answer that question, Mr. Knutson. That is outside of my field.

Mr. KNOTSON. You referred a while ago to the fact that the short terms carried a very low rate of interest.

Mr. KENT. Yes, sir.

Mr. KNOTSON. Less than 1 percent?

Mr. KENT. Yes, sir.

Mr. KNOTSON. What is going to happen when they are funded—are you going to keep on funding them into short-term securities? What was the lowest interest rate—what interest rate did the last long-term bond issue carry?

Mr. KENT. I would have to ask one of the officials in the fiscal end of the Treasury.

Mr. BELL. Two and three-fourths percent, 12 to 15 years.

Mr. KNOTSON. That is not such a low rate, when you stop to think that there is no incentive for people to put capital into anything except Government bonds. I think that is a pretty fair rate of interest.

Mr. KENT. I do not know that I would say that there was no incentive, judging from—

Mr. KNOTSON. What incentive is there, when we are going to take all their profits away from them in the form of taxes?

Mr. KENT. Judging from the recent very sharp increase in corporate earnings—

Mr. KNOTSON. Except that they gratify their gambling instinct, that is all.

Mr. VINSON. Mr. Chairman, I read here from a Washington paper dated April 3, 1936, under a New York date line [reading]:

More than 1,300 important corporations have now reported earnings for last year, showing total net income of \$2,029,990,000, a gain of 41.9 percent over the 1934 total, according to the Standard Statistics Co., of New York.

Net earnings of 1,148 industrial corporations were up 47.5 percent, to the highest figure since 1930, although about 18 percent below that year's level and about 50 percent below 1929.

Profits of 100 leading utilities increased 11.6 percent, maintaining this industry's record for relative stability. The 1935 figure was fairly close to the 1932 level and likewise to the amount recorded in 1926. Railroad earnings, although small, made a better showing than in any of the three preceding years, but were much below 1931.

Now, Mr. Kent, I would like for you to turn to page 4—

Mr. CHOWTHER. Will the gentleman yield to me for a moment on that point?

Mr. VINSON. Yes.

Mr. CHOWTHER. It would be interesting to all of us, I am sure, if there were any way to determine how much of that gain, how much of that percentage, was due in a sense to normal recovery, and how much was due to the intestinal fortitude of our American people who fight on in the face of disaster, and what proportion of it was due to the hypodermic shot in the arm of the 15 billions spent by the Treasury during that time.

Mr. VINSON. I think that is a fair observation.

Mr. CHOWTHER. You cannot find it out.

Mr. VINSON. But the fact remains that a gain has been made and prosperity is here. In other words, it is a comparative proposition. You have March 4, 1933, with thousands and tens of thousands of those registered as unemployed in a line trying to get to the bank in order to get their money out so that they can have some support for their families. And regardless of how it has happened, I think there is much to be said with respect to the gentleman from New York's idea that the fortitude of our people has had much to do with it. But certainly even my friend from New York would not say—I will not put it that way, I will say that I will say for him

that in my opinion the policies of the present administration have done much to permit the fortitude of the American people to come into its own.

Mr. CROWTHER. That may be so. I notice the gentleman did one thing, if he will yield; he has removed the corner from the problem. He says prosperity is here, that it is not around the corner any more. The corner has been taken away. And yet we are writing now a tax bill to raise more money to spend.

Mr. VINSON. The only time I heard anything about that corner was back in 1932 when we had prophecies of grass growing in the streets. Something then was said about prosperity being around the corner. Certainly I will say to my friends that we are a long way on the road.

Mr. KENTON. Will the gentleman yield?

Mr. VINSON. I would like to discuss this bill and leave our political speeches, as many as we want to make, to be made during the summer and the fall.

Mr. KENTON. Thank you. You are very generous.

Mr. VINSON. Of course, if my friend from Minnesota is coming to get rid of some of his verbosity, why, shoot.

Mr. KENTON. No; I am coming to hear you.

Mr. VINSON. I grant you you have been gone, and you missed a lot here. We welcome you back. If the tension or the pressure is such that you want to continue a little longer, I am happy to yield.

Mr. KENTON. Go ahead.

Mr. VINSON. I would like for the gentleman to take paragraph 1 on page 4 and develop the manner in which additional capital requirements may be obtained. I say frankly that I do not think there is any necessity of dealing with the first of the three methods, the sale of stock rights, because I think we understand that. But, now, in reference to the retention of the cash in the business by the use of taxable stock dividends, I would like you to develop that, because I think it is very interesting. I think that it will allay a major portion of the fear that some folks have that in this favored treatment of corporations declaring large percentages of dividends the capital structure of a corporation would be in danger, or that thereby it would not have the money for the rainy day.

Mr. KENT. What I had in mind there, Mr. Vinson, was this:

There have been several decisions recently—I may say that one of them has now reached the Supreme Court of the United States—that have taken the position that the constitutional immunity of the true stock dividend recognized or declared in *Eisner v. McComber* does not apply to all types and varieties of so-called stock dividends; for instance, that if the directors of a corporation instead of paying a large cash dividend to the preferred shareholders of the corporation see fit to give them common stock instead, that dividend of common stock is taxable so far as the constitution is concerned.

I may say that in a case which is pending before the Supreme Court there is a question also of the statutory interpretation, but assuming, as I believe is a proper legal view of the case, that so far as the Constitution is concerned, there are types of stock dividends that may be taxed under the Constitution, that would provide a loophole. Then, also, of course, there is the so-called optional stock dividend in which the stockholder is given the option of taking

cash or taking stock. For any shareholder who wishes to maintain his proportionate equity in the enterprise there is a very powerful incentive to take stock.

Mr. VINSON. The last-mentioned method, boiled down in simple phraseology, practically amounts to a sale of stock in the corporation?

Mr. KENT. That is right.

Mr. VINSON. To be paid out of the dividends that otherwise would be declared?

Mr. KENT. That is right.

Mr. VINSON. Such option is properly that has a value and, in your opinion, takes that entirely out of the stock dividend which was involved in the case of *Eisner v. McComber*; is that right?

Mr. KENT. That is correct. Since the shareholder can get cash, if he does not take cash but takes stock, it is just as though the cash were paid one day and he turned around the next day and bought the stock.

Mr. VINSON. Let us take, for instance, the case of the corporation represented here by the splendid gentleman from Mount Vernon, Mr. Conley. As I recall it, there were six owners of the common stock.

Mr. KENT. That is right; that is my recollection.

Mr. VINSON. As a practical operation, in order to get the money back into the working capital of the corporation without it bearing the maximum or a higher corporate tax rate—let us assume that the net income is \$100,000, and they needed the entire \$100,000 for working capital; if it were placed in capital or not distributed, ordinarily it would bear the 42.5-percent rate?

Mr. KENT. Yes.

Mr. VINSON. But if an option were given to the six stockholders to purchase stock, then under this method that option is taxable in the hands of the individual shareholder, subject to the individual rates as though it were money?

Mr. KENT. That is right.

Mr. VINSON. And stock is issued to the individual shareholder, commensurate with the amount of money that is put back in or used in the purchase of the stock?

Mr. KENT. Yes, sir.

Mr. VINSON. Under that sort of a case, could not 100 percent of it go back into the capital of the corporation?

Mr. KENT. That is right.

Mr. VINSON. Without the corporation paying any tax at all?

Mr. KENT. That is right. It could if the holders of that stock thought enough of the enterprise to put their money back into it.

Mr. VINSON. And if they wanted to go back in there?

Mr. KENT. That is right.

Mr. VINSON. And, under existing law, if they wanted it to stay there, it would stay, and if they did not want it to stay they could declare it out?

Mr. KENT. Declare it out, anyhow.

Mr. CROWTHER. Mr. Chairman.

Mr. VINSON. I yield to my friend from New York.

The CHAIRMAN. Dr. Crowther.

Mr. CROWTHER. You are now through?

Mr. VINSON. No, sir.

Mr. CROWTHER. Well, will you yield for the interpolation of a remark?

Mr. VINSON. Yes, sir.

Mr. CROWTHER. I just want to say to the witness that I consider that you have presented in behalf of the Internal Revenue Bureau a very clever defense of this proposition, but I think we have had evidence enough before us from the various witnesses to indicate that the difficulties and the involvements that develop in the application of this to a multitude of corporations, all with different problems, brings to me knowledge in a sense that the basic principle involved here is wrong. It is absolutely cockeyed. While there may be some merit in the proposition, and while it may be a debatable proposition—I am not going to say it is not, and set myself up as an authority—at least there is nothing debatable about the question as to whether or not this is a most unfortunate time to have such a revision of our tax structure, following years of losses during this depression period. It is most unfortunate to undertake it at this time.

Mr. VINSON. Under your statement, with reference to the retention of this money, which in effect, as you say, is the purchase price of additional stock created, the only difference between that theory and that which now exists in practice is that the money passes through the tax man?

Mr. KENT. That is right.

Mr. DISNEY. Would there not be the temptation under those circumstances for the corporation to go into receivership under the special treatment of section 5?

Mr. KENT. I should answer that question, I think, in this way, that we must assume that the courts of the country as a whole are not going knowingly to permit the resort to receivership for tax-evasion purposes.

Mr. VINSON. Is there any more reason why they would go into receivership under such a plan than they would go into receivership now, except so far as the burden to the individual shareholder of the taxes is concerned?

Mr. KENT. No; I do not think there is.

Mr. VINSON. Of course, when they go into receivership they lose control of the property, the property is in the hands of the court.

Mr. KENT. They lose control of the property, and they become subject to large fees for receivers and attorneys, such as we have been hearing a great deal about, of course, in the last 2 or 3 years.

Mr. VINSON. Mr. Kent, the third method to which you referred is the issue of interest-bearing dividend scrip to shareholders. Will you please amplify that statement?

Mr. KENT. When a dividend is declared under existing corporate law the dividend gives rise to a debtor-creditor relationship; that is, the holder of shares can actually bring suit against the corporate authorities to recover the amount of the dividend.

Instead of declaring a dividend which is enforceable by an immediate action, the corporate directors see fit to give the obligations of the corporation carrying a certain rate of interest.

There have been cases, of course, in which bonds have actually been distributed among the shareholders instead of cash by way of a dividend, and such bonds are taxable under the law as dividends according to their fair market value at the time that they are issued.

There is thus a choice between giving the shareholders an additional interest as creditors or increasing their equity in the enterprise by giving them stock.

Mr. VINSON. It is just sort of like giving them a bond as a dividend; it is just as taxable at its then market value as if you had a declaration of a dividend in kind?

Mr. KENT. That is right.

Mr. VINSON. In other words, you have dividends in property as well as money dividends?

Mr. KENT. Yes.

Mr. VINSON. And all dividends are taxable at the then market value?

Mr. KENT. Yes. To take a concrete illustration, suppose that a corporation has a net income of \$100,000 for 1936, and it has a \$75,000 obligation falling due which it has not made provision for meeting in other ways. If it issues interest-bearing scrip to its shareholders to the extent of that \$75,000, what is really happening is that the indebtedness of the corporation is being transferred from a third party to the persons who are the real owners of the enterprise.

Mr. VINSON. I yield the floor.

Mr. TREADWAY. Mr. Kent, I personally have not had the pleasure of your acquaintance but a comparatively short time. I have heard you addressed here as Mr. Kent and Dr. Kent. Is the doctor an M. D. degree, or other kind?

Mr. KENT. No; it is a J. D.; doctor of laws.

Mr. TREADWAY. Not LL. D.?

Mr. KENT. No; I cannot claim that distinction.

Mr. TREADWAY. How long have you been connected with the Treasury Department?

Mr. KENT. I have been in the Bureau of Internal Revenue 2 years this coming June.

Mr. TREADWAY. And previous to that?

Mr. KENT. I was at the University of Chicago for 7 years as a member of its law faculty, studying in the field of taxation and public law.

Mr. TREADWAY. So you are expert in the study of taxation?

Mr. KENT. I have some competence in that field.

Mr. TREADWAY. Any of it from practical experience?

Mr. KENT. Yes, sir.

Mr. TREADWAY. In the courts?

Mr. KENT. Not in the courts.

Mr. TREADWAY. All in the classroom?

Mr. KENT. In the classroom, and in outside studies and investigations.

Mr. TREADWAY. I think the students under you have been extremely fortunate in having your legal knowledge at their disposal.

Mr. KENT. Thank you. I hope they share in that opinion, Mr. Treadway.

Mr. TREADWAY. But from the practical viewpoint of actual court or tax experience, business experience, it has been rather meager, then, has it not?

Mr. KENT. Except to the extent that a wide-awake college professor not of the cloistered type picks up such experience through his various contacts and activities.

Mr. TREADWAY. That is interesting, a "wide-awake college professor."

Mr. KENT. I may say that I also have had several years of business experience before I went into the law school and into the university world.

Mr. TREADWAY. I just wanted to get your background.

Mr. KENT. Yes; surely. I am glad to give it to you.

Mr. TREADWAY. I wanted to get your background as to your expertise, as to whether or not the references you make in this statement you have submitted to us in reference to corporations, partnerships, and so forth, were based on theory or based on practical experience.

Thank you very much, sir.

Mr. LAMNECK. Did you ever run a business, Mr. Kent?

Mr. KENT. Not in an executive capacity. I happen to be one exception in a family of business executives.

Mr. LAMNECK. You never financed a business under your ideas?

Mr. KENT. No.

Mr. LAMNECK. That was in financial difficulty?

Mr. KENT. No.

Mr. LAMNECK. I was particularly interested in your reference to the report of Dr. Helvering. Maybe that is not the correct title.

Mr. HELVERING. What is that?

Mr. LAMNECK. This is Mr. Helvering, the Internal Revenue Commissioner, who made a report the other day to which you referred, saying that there were 23 partnerships with earnings of a million dollars or more.

Mr. KENT. Yes.

Mr. LAMNECK. In your illustration, in order to present the discrimination existing between corporations and partnerships, you point out that if a partnership in the class of partnerships with a million dollars or more of earnings consisted of two parties, the percentage of tax assessed was 61.04.

Mr. KENT. Yes.

Mr. LAMNECK. If there were four parties, it was 51.71 percent; five parties, 48.15 percent; and eight parties, 39.06 percent.

I would like to have you tell the committee how many partnerships there are, and who they are, in the United States, with two partners, with an income of a million dollars or more?

Mr. KENT. I wish that I were in a position offhand to give you that information, Mr. Lamneck. I am not. I will be glad to endeavor to obtain that.

Mr. LAMNECK. Do you know of any partnerships composed of four members with a million dollars or more of earnings?

Mr. KENT. I should be surprised to find if there were not at least a few; not many.

Mr. LAMNECK. Do you know any partnerships of five members with earnings of a million dollars or more?

Mr. KENT. Some of the large brokerage firms of the country, I should assume, would not have more than five partners.

Mr. LAMNECK. Would it be possible to get that information?

Mr. KENT. I will try to. I will do the best that I can. I will be glad to give it to you.

Mr. OLIPHANT. You cannot give it out.

Mr. LAMNECK. Is it not a fact that there are no partnerships in the situation as in the illustration you used, of partnerships with two partners, with four partners, with five partners, or with eight partners, earnings a million dollars or more?

Mr. KENT. I am not at all prepared to say that there are none with either five or eight partners. I think there probably are.

Mr. LAMNECK. You also referred to the fact that there were 57 with incomes of \$500,000 or over. How many such partnerships do you know of—do you know of any—with two partners, four partners, five partners, or eight partners?

Mr. KENT. I would have as much difficulty in answering, Mr. Lamneck, if you asked me if I knew of any that had 25 or 30, just because I do not happen to be familiar with particular partnerships or the number of their members.

Mr. LAMNECK. Assuming for argument's sake that there are not in any of those classifications, the illustrations you use here in this table would not be fair as to the taxes paid by corporations, then, would they?

Mr. KENT. I would not answer that question with an unqualified affirmative for this reason, that there might be situations where the discrimination between a partnership and a corporation would give you the explanation of the fact that there were no partnerships; that is, there are some types of partnerships that cannot incorporate, law firms, for instance. I believe the same thing is true of brokerage firms in New York, because they are not permitted to hold seats on the New York Stock Exchange as corporations. They remain partnerships by virtue of necessity.

Where they have a choice as to whether they will be one or the other, when you get an enterprise of that sort, for tax considerations alone it would be very foolish if it did not incorporate.

Mr. LAMNECK. That is all.

Mr. REED. Mr. Kent, I have been very much interested in your statement.

Were you here the day that Mr. David Stock of 170 Broadway, New York, testified?

Mr. KENT. Yes, sir; I was.

Mr. REED. Were you the man who invited him by telephone to come here before the committee?

Mr. KENT. I do not say that I invited him, Mr. Reed. I said that I had been interested in the statement of his views, and thought that they were worth being brought to the attention of the committee.

Mr. REED. Did you suggest that he come here and testify?

Mr. KENT. I suggested that if he desired to do so he was privileged to appear.

Mr. REED. He was privileged to appear?

Mr. KENT. I assumed that he would be, the same as any other citizen.

Mr. REED. You telephoned to him?

Mr. KENT. I talked to him over the telephone.

Mr. REED. Did you call for that specific purpose?

Mr. KENT. He had put in a telephone call to my office several days before for another purpose, and I was also answering that call.

Mr. REED. Had you already read his letter that was sent out?

Mr. KENT. Yes; I had.

Mr. REED. Who sent that letter to you?

Mr. KENT. The letter was sent in, I assume, by Mr. Boake Carter, the radio announcer.

Mr. REED. Was it sent to you?

Mr. KENT. Not to me.

Mr. REED. Do you know to whom it was sent?

Mr. KENT. No.

Mr. REED. Was it sent to the Treasury?

Mr. KENT. I think that it was.

Mr. REED. You are not positive about that?

Mr. KENT. No.

Mr. REED. He said here in his testimony in response to Mr. Treadway's question:

May I state the reason I am here? I had occasion to hear Mr. Boake Carter make a speech on the radio one evening, and I wrote him a letter criticizing his speech. That letter was sent to the Treasury.

It was a reading of that letter that caused you to suggest that he come here and express his views?

Mr. KENT. It was partly that, and partly my knowledge of his very considerable background in the field of corporate finance.

Mr. REED. As a part of his background was he connected with the Treasury?

Mr. KENT. No; he was not connected with the Treasury.

Mr. REED. Has he ever been connected with the Treasury?

Mr. KENT. For a very short time, as a special attorney.

Mr. REED. What is his connection with the Government now?

Mr. KENT. He is at the present time engaged as a special counsel, I believe, for the Communications Commission.

Mr. REED. You do not know whether it is that or whether he is special investigator?

Mr. KENT. No; I do not. I think that he is working, Mr. Reed, in this telephone investigation, but I do not know the details of it.

Mr. REED. How long has he been in that connection?

Mr. KENT. I could not say precisely. Several months, I think.

Mr. REED. You are familiar with the law, I assume, with reference to employees of the Government appearing before a committee without an invitation on the part of the committee?

Mr. KENT. No; I am not.

Mr. REED. I ask, Mr. Chairman, the privilege of inserting a copy of that law in the record, and also the penalty prescribed by the Code for a violation of that character. I assume that you did not invite him here, Mr. Chairman.

The CHAIRMAN. I have not invited anyone.

Mr. REED. And no member of the committee invited him. He came here in response to a telephone suggestion on the part of the Treasury.

I would like the privilege of quoting the statute, which is brief.

The CHAIRMAN. Without objection it may be incorporated.

Mr. BUCK. Mr. Chairman, will the gentleman yield?

Mr. REED. I yield.

Mr. BUCK. Do I understand that this gentleman to whom you are referring is an employee of one of the departments of the Government?

Mr. REED. Yes.

Mr. BUCK. I understood he was employed by an investigating committee of the House, of Congress.

Mr. REED. He is employed by the Communications Commission.

Mr. BUCK. By the Communications Commission?

Mr. REED. Yes. I asked him the question as to whether he was here lobbying, and he declined to answer.

The CHAIRMAN. We thank you, Mr. Kent, for your appearance and the testimony you have given the committee.

Mr. REED. Mr. Chairman, before you go further, I would like to insert in the record this brief statement, which includes the material which I mentioned a moment ago.

The CHAIRMAN. Without objection it may be inserted in the record.

(The statement submitted by Mr. Reed follows:)

STATEMENT OF REPRESENTATIVE DANIEL A. REED, OF NEW YORK

On Friday, April 3, a man who identified himself as "David Stock, attorney, 170 Broadway, New York" appeared before the Ways and Means Committee in support of the President's tax proposal.

In answer to a direct question concerning his business, Mr. Stock said he was not counsel for any corporation but, he said "I am associated with a firm that is counsel for many corporations."

Further questioned as to whether he appeared in the interest of anybody but himself, he said "May I state the reason I am here? I had occasion to hear Mr. Boake Carter make a speech on the radio one evening, and I wrote him a letter criticizing his speech. That letter was sent to the Treasury. The Treasury communicated with me and asked me if I would care to state my views before this committee. That is why I am here."

When I asked Mr. Stock whether his expenses were being paid by the Treasury, he replied "No they are not. I am here on my own business."

When I further questioned Mr. Stock "You are just lobbying for the Treasury at the present time?" he failed to answer.

I can now understand Mr. Stock's eager support of the President's tax plan because I have learned that he is chief investigator for the Federal Communications Commission, located at 195 Broadway, New York City.

It is a disgraceful procedure that this administration should foist upon the Ways and Means Committee a Government employee posing as a disinterested, private citizen to give his advice on the pending tax bill. To put it mildly, they have resorted to rather sharp practices to trump up support for the administration's tax measure.

The Ways and Means Committee and every other committee in Congress is entitled to know the background and business connections of witnesses who appear for the purpose of giving advice on pending legislation. Furthermore, I trust that the Treasury Department and Federal Communications Commission have not lost sight of title 31, section 15 of the Code of Laws of the United States which provides: " * * * no recommendation as to how the revenue needs of the Government should be met shall be submitted to Congress or any committee thereof by any officer or employee of any department or establishment, unless at the request of either House of Congress."

Title 18, section 201 of the Criminal Code provides:

"Use of appropriations to pay for personal service to influence Member of Congress to favor or oppose legislation: No part of the money appropriated by any Act shall, in the absence of express authorization by Congress, be used directly or indirectly to pay for any personal service, advertisement, telegram, telephone, letter, printed or written matter, or other device, intended or designed to influence in any manner a Member of Congress, to favor or oppose, by vote or otherwise, any legislation or appropriation by Congress, whether before or after the introduction of any bill or resolution proposing such legislation or appropriation; but this shall not prevent officers and employees of the United States from communicating to Members of Congress on the request of any Member or to Congress, through the proper official channels,

requests for legislation or appropriations which they deem necessary for the efficient conduct of the public business.

"Any officer or employee of the United States who after notice and hearing by the superior officer vested with the power of removing him, is found to have violated or attempted to violate this section, shall be removed by such superior officer from office or employment. Any officer or employee of the United States who violates or attempts to violate this section shall also be guilty of a misdemeanor and on conviction thereof shall be punished by a fine of not more than \$500 or by imprisonment for not more than one year, or both."

The CHAIRMAN. The next witness is the Honorable Herman Oliphant, general counsel of the Treasury Department.

STATEMENT OF HERMAN OLIPHANT, GENERAL COUNSEL, TREASURY DEPARTMENT

The CHAIRMAN. Mr. Oliphant, your presence was requested by the Treasury at the instance of the committee?

Mr. OLIPHANT. Yes, sir.

The CHAIRMAN. Have you any statement you would like to make other than to answer questions?

Mr. OLIPHANT. I have no statement to make. It seems to me that the general aspects of the question have been quite well presented. But I am here and Mr. Bell is here, the Acting Director of the Budget, to answer questions if we can be helpful.

The CHAIRMAN. Mr. Treadway has requested that both of you appear before the committee. I have invited no one, but I have been willing for anyone to come whom any member of the committee desired to be heard. So, Mr. Treadway, we will yield to you now.

Mr. TREADWAY. I was under the impression, Mr. Oliphant, from what I have read in the press, that you have been appointed either Under Secretary or Assistant Secretary of the Treasury, but evidently I was mistaken about that.

Mr. OLIPHANT. No, sir; I am General Counsel for the Treasury.

Mr. TREADWAY. How long have you held that position?

Mr. OLIPHANT. Two years.

Mr. TREADWAY. Since about the time you first appeared before this committee?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. Previous to that?

Mr. OLIPHANT. General Counsel for the Farm Credit Administration.

Mr. TREADWAY. That is still another governmental position?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. Previous to your joining the administrative forces, how were you occupied?

Mr. OLIPHANT. I was engaged for the period of 5 years in studying the administration of justice in the courts of New York.

Mr. TREADWAY. You studied in the courts?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. Practicing in the courts?

Mr. OLIPHANT. No.

Mr. TREADWAY. Just studying.

Mr. OLIPHANT. Studying the administration of justice in the courts of New York under the auspices of the Johns Hopkins University.

Mr. TREADWAY. You originally were a professor in Chicago, were you not?

Mr. OLIPHANT. Yes, sir; I was a member of the law faculty of the University of Chicago.

Mr. TREADWAY. Were you at any time a practicing attorney in the courts?

Mr. OLIPHANT. To some extent in Chicago and somewhat more in New York. I afterward went to Columbia.

Mr. TREADWAY. You were a professor in Columbia, were you not?

Mr. OLIPHANT. In the law school at Columbia University; I taught law there.

Mr. TREADWAY. In the Columbia University Law School. So that as a professor there is no question about your qualifications as to tax knowledge?

Mr. OLIPHANT. I will let you put your own estimate on that. Mr. TREADWAY. Modesty would perhaps prevent you from agreeing, but I think that is true. I think there is no question of your expert knowledge from the viewpoint of a student of tax law.

You attended our executive meetings for a long time?

Mr. OLIPHANT. Yes, sir; quite a number of them.

Mr. TREADWAY. Were you authorized to represent the Secretary of the Treasury?

Mr. OLIPHANT. I was—

Mr. TREADWAY. You were?

Mr. OLIPHANT. Well, Mr. Helvering was representing the Secretary of the Treasury, and I was assisting him.

Mr. TREADWAY. You and Mr. Helvering?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. At the authority of the Secretary of the Treasury.

I think the first information that we had as to this tax program that we have before us came from the President's message. Are you authorized to speak for the President on his tax recommendations?

Mr. OLIPHANT. I am not.

Mr. TREADWAY. Is Mr. Helvering, Dr. Helvering, as he was given the title a few minutes ago—

Mr. HELVERING. You have known me too long, Mr. Treadway.

Mr. TREADWAY. Then, we are not favored with any authoritative spokesman for the President, evidently, are we?

Mr. OLIPHANT. We will try to answer any questions we can. I doubt the propriety—I have not been in Government service very long; older and wiser men would know—of my standing here and saying that I was authorized to speak for the President.

Mr. TREADWAY. The only reason I bring that up is in no way critical—

Mr. OLIPHANT. No; I know it is not, Mr. Treadway.

Mr. TREADWAY. Only I did bring up a similar question 2 or 3 years ago, and at that time Mr. Morgenthau appeared and abso-

in my presence authorized a gentleman to appear for him. That was the only reason that I was approaching that angle with you, sir. It was simply to see whether you stood in the same light as Dr. Magill. Mr. Morgenthau did definitely authorize Dr. Magill to appear for him, and I was just trying to see what your idea was about that.

Mr. VINSON. If I understood the gentleman correctly, he said that the Secretary of the Treasury was represented by Mr. Helvering, and he was assisting Mr. Helvering.

Mr. TREADWAY. I understood the same thing. Now we are in perfect accord on that. I am so delighted we can occasionally be in accord.

Mr. VINSON. One question on qualifications, please.

How long have you been in Washington connected with the Government?

Mr. OLIPHANT. Since the early part of 1933; that is my experience at this time. During the war I was here with the War Trade Board for a period of a year or so.

Mr. TREADWAY. Was there not one bill on which the Secretary did authorize you to speak—namely, the silver bill?

Mr. OLIPHANT. I spoke on the silver bill.

Mr. TREADWAY. Was not that with some authority from Mr. Morgenthau?

Mr. OLIPHANT. I was authorized to speak on the drafting of the silver bill.

Mr. TREADWAY. I remember we asked you the question at that time where the policy came from, and you said it was not your job to establish the policy; it was simply to draft a measure; is not that right?

Mr. OLIPHANT. That is right; I recall that very well. That was my first opportunity of meeting you. I recall very well that you asked me that a number of times.

Mr. TREADWAY. You, of course, read Mr. Commissioner Helvering's testimony before the committee and probably heard most of it?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. Of course, that has your approval?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. Do you desire to make any further statement in support of the report of the subcommittee? Are there any details that Mr. Helvering and Dr. Kent have not covered with which you would like to provide us at this time?

Mr. OLIPHANT. I do not believe I could add much to what has been said.

Mr. TREADWAY. You think the whole case is in for the Government, do you?

Mr. OLIPHANT. I think the thing has been pretty well presented.

Mr. TREADWAY. I do not think it is for the public, but it may be in for the Government.

Then I should assume that you do not care to add anything in the way of approval and, of course, you have nothing to disapprove of in the statements of either of those gentlemen. Am I correct?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. You say as a private lawyer in law practice you have not had very much experience in the administration of tax laws?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. But as a professor you have had a good deal?

Mr. OLIPHANT. Yes; I have worked on tax problems a good deal.

Mr. TREADWAY. In order to disseminate your knowledge to the students in your classes?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. What about the interpretation? You say you are not qualified to speak here much for the administration of tax laws, but what about their interpretation?

Mr. OLIPHANT. I have done my share of the work in interpreting statutes of various sorts.

Mr. TREADWAY. What do you consider to be the effect on business of either these taxes—well, let us speak of the existing taxes first.

Mr. OLIPHANT. That gets you into the field of business administration. I wonder how much I can add on that.

As I have thought about this general problem of providing more money, three phases of it have projected themselves up as headlands. The first is that by the invalidation of the A. A. A. and by the passage of the soldiers' bonus the whole budget picture is thrown into disarray. The immediate thing from the standpoint of the welfare of the Federal credit, which is our first concern—and by "our" I mean the Treasury and the Ways and Means Committee—is not when the Budget is balanced, whether this month or next month, or this year, or next year, but that the representations which have been made by the President, as he is authorized and required by law to do, as to what the probable outlays are going to be and as to what the probable receipts are going to be, shall be made good.

The thing that struck me most about those who have appeared in opposition to this bill, in view of what they have said about balancing the Budget, is that they did not, everyone, open up by saying, "We are here to back up the members of this committee in its effort to make good the Budget message", because it is not what I have in my pocket that determines my credit, it is not when I pay my debts, but, am I as good as my word? That is the first thing that is on my mind.

The second thing that sticks up out of this whole picture as a headland is that we are talking about raising real money which has to come out of real people's pockets, and the responsibility is to lay that added burden—reluctantly—in those places that will produce the least hardship. Fairness permits of nothing else. That is statesmanship.

Men having taxes to pay, whether you or I or any other taxpayer, can pay taxes only from one of four sources of receipts, apart from a capital levy. Unless we go into the taxpayer's capital and take part of his capital, there are four and only four sources from which he can pay taxes:

The first is receipts from business profits. The second, wages and salaries. The third, receipts from rents. The fourth is receipts from interest.

With the exception of minor items, which I will leave out, such as royalties, there are no other possibilities.

I think the thing that gratifies us all most when we adjourn all sentiments except our disinterestedness for the welfare of the country, the thing that gratifies everybody in this room most, right now, is the enormous increase there has been in business activity as reflected in business profits. I think we all hope that they will grow and keep on growing. It is no time to raise the tax rates on business profits—I am talking now about the tax rates on business profits. Unless there has been a commensurate increase—and I am going to come in a moment to point out the dimensions of that increase in corporate profits that gratify us all so much—in receipts from wages and salaries or from rents or from interest, then we minimize the hardship of the added tax burden by laying it where the increases in receipts are greatest.

The national income paid out rose 8 percent last year, an increase of a little more than four billions over 1934.

Mr. VINSON. What is the figure?

Mr. OLIPHANT. Eight percent.

Mr. VINSON. What is the figure in dollars?

Mr. OLIPHANT. The absolute figures are from about 50 billion to 54 billion.

Mr. KNUTSON. Will the gentleman yield right there? Will the gentleman from Massachusetts permit a question?

Mr. TREADWAY. Surely.

Mr. KNUTSON. Does that include business pickup as a result of money spent through the P. W. A. and W. P. A.?

Mr. OLIPHANT. Everybody's income.

Mr. KNUTSON. How many billions of dollars did you say?

Mr. OLIPHANT. Four billion.

Mr. KNUTSON. Four billions, and we have spent seven billions, so there must be some water left in the pump that we have not got out yet.

Mr. OLIPHANT. The profits of a representative group of 1,307 corporations, as calculated by standard statistics, rose 42 percent for the year 1935 over 1934.

As to this increase in business profits, the most encouraging thing in the whole picture is that the increase is at an accelerated rate, for if you take the 161 corporations which Standard Statistics uses as representative corporations for reflecting trends in corporate profits, you find that during the second quarter of 1935 there was an increase of 69 percent over that for the third quarter of—

Mr. WOODRUFF. What year was that?

Mr. OLIPHANT. I am talking now about the increase in 1935 over the corresponding quarter in 1934. During the third quarter of 1935 the profits of this group of 161 representative corporations chosen for that statistical purpose increased 69 percent over the corresponding quarter in 1934.

Mr. WOODRUFF. Will you yield just there?

Mr. OLIPHANT. May I just add the final figure? And in the last quarter the increase between the 2 years was 117 percent.

Mr. WOODRUFF. May I ask you now a question just there?

Were these profits largely made after the opinions in the N. R. A. and the A. A. A. cases had been handed down by the Supreme Court?

Mr. OLIPHANT. I am probably beyond my depth now in talking about this nonlegal stuff, but I cannot undertake to identify the particular causes that account for the shape of that curve of business profits. I wish I could.

Mr. McCORMACK. How many corporations did you say; 1,300?

Mr. OLIPHANT. In the figures for the year 1935 as compared with 1934, there were in that group 1,307 corporations.

Mr. McCORMACK. I have a record here of 2,010 industrial, public utility, and financial companies, from the report of the National City Bank of New York, which I just received—we all receive it—showing that the combined net profits less deficits of those 2,010 companies were \$2,541,000,000 in 1935 as compared with \$1,789,000,000 in 1934, representing an increase of 42 percent. Upon the aggregate net worth of \$49,824,000,000 the rate of return was 3.5 percent in 1934 and 5.1 percent in 1935.

Mr. TREADWAY. I am listening. Whenever the gentleman has finished his present statement I would like to continue my inquiry.

Mr. COOPER. May I make one inquiry there?

The Standard Statistics institution to which you refer is, we all know, an independent agency which is in no way connected with the Government. It is a statistical institution that is an authority separate and apart from any governmental connection?

Mr. OLIPHANT. That is right. It is an institution that makes its living by supplying dependable figures to the business community.

Mr. COOPER. And it is accepted as an authority in that field?

Mr. OLIPHANT. It is.

Mr. TREADWAY. When you were interrupted I understood there were three divisions, and you have not touched the third one yet.

Mr. OLIPHANT. I am coming to the next headland now: What methods are available if this increased sum is to be obtained dominantly from this one of the four possible sources—and whether or not it should be depends upon whether or not there has been a corresponding increase in those other three. It is a matter, I suppose, of common knowledge that people's receipts from interest are going down and not up. The whole trend of interest rates is down, and people's receipts from those sources are going down. I think the figures would show that people's receipts from rents have been moving along slightly up, just slightly up. The figures will also show that, as we come out of the depression this time, just as in all previous times, there is quite a lag before the increase in business profits gets itself reflected in corresponding increases in wages and salaries. So that, and I am only telling you how I have thought about the problem, as I see it, that seems a localized place where the additional money can be obtained with the minimum hardship, bearing in mind always that business profits are nothing but an index of business activity, and the concern of all of us is in the expansion of business activity.

The CHAIRMAN. I do not want to break into the continuity of your remarks, but you gave a comparison of the profits from busi-

ness of the increase in business in the different periods comparing 1935 with 1934.

Mr. OLIPHANT. Yes, sir.

The CHAIRMAN. Can you not give such a comparison for 1935 with 1932 and 1933, when you revise your remarks?

Mr. OLIPHANT. I would be glad to.

The CHAIRMAN. That would be interesting to me, to see what has been the increase since this administration went in.

Mr. OLIPHANT. I tried to keep my figures outside of debatable ground. I would like to confine my observations on the subject to the merits.

Mr. KNOTSON. Will you at that point also put in the amount of the Government has spent toward recovery? We would like to know at what rate the curve went upward since the Supreme Court knocked out the N. R. A., also.

Mr. TREADWAY. Are you ready for further questioning?

Mr. OLIPHANT. May I go ahead?

Mr. TREADWAY. Certainly.

Mr. OLIPHANT. If that is the area—if you follow my thought and I am merely reflecting my own thinking about the thing—where we can get the additional money with a minimum of hardship and without jeopardizing the public interest, then the question becomes, how do that?

Mr. TREADWAY. Let me interrupt you right there for a moment, because you have repeated the phrase about the least hardship on business.

Is it not true that the witnesses whom we have had before us representing their own business interests have endeavored to set up the fact that this would be a tremendous hardship on them and put them out of business in many instances?

Mr. OLIPHANT. What I tried to say was the least hardship on the people as a whole, looking at all taxpayers, business and non-business, and realizing that no taxpayer has any but four sources out of which he can pay his taxes.

I am now asking the preliminary question that we debated in the Treasury with those studying these problems all the time: Where dominantly ought we look for the added money? If we are right about that so far—and there may be a difference of opinion on that; I grant that; there may be good reasons in some people's minds for throwing an added tax burden on wages and salaries at this time, a general increase in the income-tax rates or broadening the income-tax base. Others might have reasons for putting a tax on the ownership of land or on rents or on something else. But just grant that, as we look at it, we are going to seek this money from this area of abundance rather than from these other three areas of relative dearth. Then there is one of three ways to do it:

By a drastic increase in the corporation income tax, which would probably amount to some 25.5 percent and would further accentuate the inequalities and inequities that our present corporation income-tax law involves when compared with how we tax individual businesses and partnerships.

A second possibility would be the imposition of a steep excess-profits tax, and a great deal may be said for that quite apart from its administrative difficulties.

The third possibility is the plan before the committee, and that brings me to the third big fact:

When you take Mr. McLeod's figures as shown on his big chart, the increase in income going to various people by a hypothetical full distribution of corporate earnings, what you find is this, that of the 4 billions added, 3 billions go to people who pay personal income taxes above 15 percent. That means that under this plan you place the added burden in the area of abundance rather than dearth, and you get all the money required by stopping the avoidance of the surtaxes.

That is all I want to say.

Mr. TREADWAY. Are you now ready for another question? I would like to get back a little nearer to our hearing. We are very much interested in your discussion.

Commissioner Helvering in the course of his statement quoted Dr. Adams, whom we all remember very delightfully, as favoring a tax upon undistributed earnings. Would you be willing to describe the specific proposal which he approved and compare it with the one now under consideration? Was there not quite a marked difference between what Dr. Adams approved and the one we are now considering?

Mr. OLIPHANT. Others are better acquainted with the literature on the subject than am I, but as I recall, Dr. Adams advocated a compromise or half-way position on the thing, that is, he would have added to the then corporation income tax of I think 10 percent a tax on undistributed earnings.

Mr. TREADWAY. Will you then describe what this is?

Mr. OLIPHANT. Since that time as well as before that time, this proposal has had a great deal of study and consideration and a great deal of debate. It is one of those improvements in our tax law that, like all improvements in tax law, get themselves accepted slowly. The country debated, Congress considered, and students wrote about the income tax for a much longer period of time before it came to be accepted.

Mr. TREADWAY. The cause of the delay then was the fact that a constitutional amendment had to be adopted.

Mr. OLIPHANT. I am talking about the income tax before we knew that it was unconstitutional.

Mr. TREADWAY. Before it went into the courts?

Mr. OLIPHANT. Exactly.

Mr. TREADWAY. Way back.

Mr. OLIPHANT. What this does is to adopt these two propositions: First, that business profits, by whomever derived and from whatever form of business derived, should all bear the same tax burden, just because it is right; and, second, that it is not for anybody in Washington to tell business executives how much of their earnings they shall keep back and how much they shall distribute. That is not the Government's business. I am stating my own convictions. But it is the Government's business to see to it that those administering the affairs of a corporation shall not use it, nor permit it to be used, for avoiding the surtaxes which everybody else has to pay. That is what this does.

Mr. TREADWAY. And that is the justification that you set up for this method?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. Now, Professor, I read and heard it stated around—

A MEMBER OF THE COMMITTEE. Doctor.

Mr. TREADWAY. Both. Am I not right in addressing you as professor, sir?

Mr. OLIPHANT. Quite; I am honored.

Mr. TREADWAY. Thank you. I understood when you gave your qualifications before the committee that you had spent a good many years as a professor.

Mr. OLIPHANT. My happiest years.

Mr. TREADWAY. My colleague corrects me and thinks you should be addressed as "Doctor." However, either title is correct, I assume?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. Why you smiled when I used the title "Professor" I am not certain.

Mr. VINSON. Will my friend from Massachusetts yield?

Mr. TREADWAY. I was just going to ask the gentleman a question.

Mr. VINSON. In that connection, about his title.

Mr. TREADWAY. About his title?

Mr. VINSON. Yes.

Mr. TREADWAY. Certainly.

Mr. VINSON. Do you refer to the gentlemen who have been retained by the Republican National Committee to write the speeches, 14 or 15 in number, as "Doctors" or "Professors"?

Mr. TREADWAY. It would be interesting if we knew about that.

Mr. Chairman, in view of certain members of the committee finding fault with the germaneness of evidence, I submit the question was not germane to the subject before us.

Now, Professor, I have been reliably informed that you were the one first responsible for the suggestion of this new tax on corporations.

Mr. OLIPHANT. That is not correct.

Mr. COOPER. Mr. Chairman, will the gentleman yield in that connection?

Mr. TREADWAY. Yes.

Mr. COOPER. Would you be prepared to give us a brief history of legislation of this type that has been advocated throughout the years in the past?

Mr. OLIPHANT. I shall be delighted to, if Mr. Treadway would like me to answer his question that fully. It will take a minute or two.

Mr. COOPER. All right; but he yielded to me.

Mr. TREADWAY. At this particular stage, who is responsible for the suggestion before us?

Mr. OLIPHANT. I shall be delighted if you want me to give you the history.

Mr. TREADWAY. When this was proposed previously Congress has thrown it out; sometimes it has not even reached the floor. I think it was passed or was favorably reported in the Senate once, this idea, was it not?

Mr. OLIPHANT. Just as other—

Mr. TREADWAY. I am only referring to the present time, to the plan whose adoption seems to be very seriously considered by the administration now. That is what I am inquiring, as to who suggested

the adoption of this particular program now before the Ways and Means Committee?

Mr. OLIPHANT. I shall be delighted to answer that. The matter of possible sources of additional revenue is the subject of constant study in the Treasury Department. Specifically, in the Bureau of Internal Revenue in the section devoted to legislation and regulations, ongoing studies are in progress all the time. When, as on this occasion, we are confronted with a duty, as we see it, to supply the President with the information in terms of which he may discharge his duty to recommend taxes to the Congress, this is what happens:

We get the men together who work on possible taxes—and this is what happened in this case—and back of their work is this mechanism—that is, all of these people in the Bureau are engaged from day to day in the administration of the tax laws arrange to have brought to their attention desirable changes in the tax laws: These are all funneled and channeled into a place where they can be scrutinized and the best salvaged for the consideration by you experts here on the hill—they all got together and put down a whole list of possible taxes such as was laid before the subcommittee in its executive sessions. When it came to that portion of the program which had to do with raising additional revenue necessary to take care of the permanent agricultural program and to pay the bonus, this one stuck out because—and I do not think you can get away from this—when the country is advised of two facts, this increase in business profits which we all welcome, and the present avoidance of surtaxes which everybody else has to pay, and which amounts to \$620,000,000, the problem of choice was over. That is the reason this was chosen and recommended to the President, with the hearty endorsement of everybody in the Treasury and the Bureau of Internal Revenue who worked on it.

Mr. TREADWAY. Were any officials outside of the Bureau of Internal Revenue or the Treasury consulted? For instance, was Mr. Eccles taken into the conference?

Mr. OLIPHANT. He was not.

Mr. TREADWAY. Was Mr. Tugwell?

Mr. OLIPHANT. He was not.

Mr. TREADWAY. You consider Mr. Tugwell's advice good, then?

Mr. HILL. Did you say he was or was not?

Mr. OLIPHANT. He was not.

Mr. TREADWAY. Did you say "not" to Mr. Eccles?

Mr. OLIPHANT. He was not.

Mr. TREADWAY. Did you say "not" to both of them?

Mr. OLIPHANT. Neither was.

Mr. TREADWAY. Oh! I understood you to say "yes". The "not" was very mild.

Mr. OLIPHANT. Yes. I swallow the end of my sentences. My stenographers tell me that.

Mr. COOPER. Mr. Chairman, will the gentleman yield there?

Mr. TREADWAY. Yes; briefly, but I would like to conclude my inquiries; if the gentlemen will give me a chance, I will.

Mr. COOPER. Mr. Oliphant, the arrangement you have described in the Treasury Department about the study from day to day of these problems has always obtained there, has it not?

Mr. OLIPHANT. It has.

Mr. COOPER. Regardless of which party is administering the affairs of the Government and the Treasury Department?

Mr. OLIPHANT. That is what I understand.

Mr. COOPER. That goes on all the time, does it not?

Mr. OLIPHANT. That is my understanding, it does.

Mr. COOPER. As a part of the work of that Department?

Mr. OLIPHANT. Mr. Kent tells me that is true.

Mr. COOPER. Many of these men engaged in that have been there for years?

Mr. OLIPHANT. That is right, regular civil-service employees that have been there for years.

Mr. TREADWAY. But their superior officers are not civil service.

Let me inquire whether you consulted people outside of the Government in relation to this idea as, for instance, bankers or their representatives?

Mr. OLIPHANT. We have not; we did not.

Mr. TREADWAY. Did you talk to any investment bankers?

Mr. OLIPHANT. No.

Mr. TREADWAY. No bankers of any kind?

Mr. OLIPHANT. No, sir.

Mr. TREADWAY. Any business people?

Mr. OLIPHANT. No.

Mr. TREADWAY. None?

Mr. OLIPHANT. No, sir.

Mr. TREADWAY. Any professors?

Mr. OLIPHANT. Mr. Magill worked with us on it.

Mr. TREADWAY. A splendid authority.

Mr. OLIPHANT. A very level-headed man.

Mr. TREADWAY. How about Professor Frankfurter, did he get into the picture at all?

Mr. OLIPHANT. He did not.

Mr. TREADWAY. He did not?

Mr. OLIPHANT. He did not.

Mr. TREADWAY. Thank you. That is one thing to its advantage then.

In your opinion is this proposed tax on corporate incomes workable from the taxpayer's point of view?

Mr. OLIPHANT. I believe it is.

Mr. TREADWAY. Is it reasonably capable of administration?

Mr. OLIPHANT. I believe it is.

Mr. TREADWAY. Will litigation be increased or decreased as compared with the present law?

Mr. OLIPHANT. I see no occasion for an increase in litigation.

Mr. TREADWAY. No increase in litigation?

Mr. OLIPHANT. I should see reasons why the problem of litigation would be simplified by the number of taxes that are being repealed.

Mr. TREADWAY. You repeat that it is in your judgment perfectly fair and equitable to the taxpayers?

Mr. OLIPHANT. I do. I think it is grounded in equity.

Mr. TREADWAY. How is the taxpayer going to compute this tax, can you tell us?

Mr. OLIPHANT. I would like to yield on matters of figures to Mr. McLeod and other people who have more competence in those than I have.

Mr. TREADWAY. You would prefer not to touch on the subject of the computation?

Mr. OLIPHANT. If you please.

Mr. TREADWAY. Is it not going to be hard to determine your net income under this?

Mr. OLIPHANT. The net taxable income, I assume, would be—

Mr. TREADWAY. Yes.

Mr. OLIPHANT. But as I say, when it comes to a matter of computation of a tax, I would prefer to yield to someone who could answer with greater competence than I can. I would be taking your time and giving you stuff of doubtful value.

Mr. TREADWAY. If you prefer not to be interrogated upon it, very well.

Would you answer this question:

Is there any revenue act which you can say has been fully adjudicated without any doubt as to all the questions which may arise under it?

Mr. OLIPHANT. None that I know of.

Mr. TREADWAY. You do not think it will increase litigation?

Mr. OLIPHANT. None that I know of. I assume that all revenue legislation has at some stage in its history been subject to litigation, assuming it was on the books long enough.

Mr. TREADWAY. Why will not this add to litigation?

Mr. OLIPHANT. Because you are repealing a number of taxes.

Mr. TREADWAY. All litigation would be concentrated in this one, then?

Mr. OLIPHANT. In the simplified form of tax; yes. It is a great simplification of the tax structure, and I think the most important tax reform since the adoption of the income tax.

Mr. TREADWAY. Can you supply the committee with any of the following statistics for the period of 1, 2, or 3 years, and as recently as possible:

The number of revenue agents' reports proposing additional deficiencies, aggregate additional taxes proposed, and the aggregate amount collected?

Mr. OLIPHANT. I shall be delighted.

Mr. TREADWAY. That you have available?

Mr. OLIPHANT. Not at the moment, but I can get it.

Mr. TREADWAY. The number of deficiency letters and the aggregate deficiencies asserted?

Mr. OLIPHANT. I can get those. They are kept current.

Mr. TREADWAY. The number of petitions to the Board of Tax Appeals, and aggregate deficiencies involved there?

Mr. OLIPHANT. That is available.

Mr. TREADWAY. That is a matter of current record?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. All of these items you will be able to supply?

Mr. OLIPHANT. We will supply them.

Mr. TREADWAY. Number of cases considered by the technical staff?

Mr. OLIPHANT. That is available.

Mr. TREADWAY. Number of decisions per year of the Board of Tax Appeals?

Mr. OLIPHANT. That is also available.

Mr. TREADWAY. Number of refund claims filed?

Mr. OLIPHANT. We have that.

Mr. TREADWAY. Number allowed?

Mr. OLIPHANT. We have that also.

Mr. TREADWAY. And the amounts?

Mr. OLIPHANT. That I can give you, the aggregate.

Mr. TREADWAY. Do you have this: The number of cases now pending in courts, either suits for refund, appeals from the Board of Tax Appeals, or others?

Mr. OLIPHANT. Yes; in as reliable form as judicial statistics can be had.

Mr. TREADWAY. The ratio of additional taxes asserted and the amounts finally determined to be due in cases settled without issuance of a deficiency letter?

Mr. HELVERING. Read that again.

Mr. OLIPHANT. Will you read that again?

Mr. TREADWAY. Then I think you are prepared to furnish this: Number of cases considered by the General Counsel's Office, Bureau of Internal Revenue? I do not doubt that is available.

Mr. OLIPHANT. Yes.

Mr. TREADWAY. All of these inquiries I have been asking you to supply were provided to the committee and it received them in 1925. It seems to me it would be well worth while to bring those up to date.

Mr. OLIPHANT. We shall be delighted to give you those figures.

Mr. TREADWAY. You agree that they are desirable to have?

Mr. OLIPHANT. Yes. The more widely known the better, those figures.

Mr. TREADWAY. Surely, because I do not think we have been oversupplied with information here from the officials of the Government. We formerly used to.

Mr. OLIPHANT. We have tried not to respond grudgingly when requested. I am very glad indeed to give you this information.

Mr. TREADWAY. Thank you.

Mr. Helvering in his testimony before the committee did not discuss the needs of the additional revenue. Of course the President's message touches on that point. Perhaps that was all that was necessary. What is your view on the needs of additional revenue?

Mr. OLIPHANT. Mr. Bell, the Acting Director of the Budget, is available to talk about the needs of additional revenue, since that is his primary responsibility.

Mr. TREADWAY. We will leave that for Mr. Bell to answer. You have not looked into the needs, then from the standpoint of the Treasury, as to whether or not there is real need of more revenue at the present time?

The CHAIRMAN. Will the gentleman yield?

Mr. TREADWAY. Certainly.

The CHAIRMAN. I thought that was one of the first statements he made.

Mr. TREADWAY. I was asking him to elaborate on the need, and he referred me to Mr. Bell.

Mr. OLIPHANT. At the outset I made the statement that what this legislation is aimed at is to restore the budget picture to what it was prior to the invalidation of the A. A. A. processing taxes and the passage of the soldiers' bonus.

Mr. TREADWAY. Those two items?

Mr. OLIPHANT. Yes. In your last question I assumed you wanted information with reference to the details, and Mr. Bell has those details.

Mr. TREADWAY. I want to know more about the difference between the ordinary receipts and expenditures and what we have learned to know as extraordinary or emergency expenditures.

Mr. OLIPHANT. That is a part of Mr. Bell's competence.

Mr. TREADWAY. Do you not think that some of the needs of new revenue could be accomplished by reduction in expenditures?

Mr. OLIPHANT. I could not illuminate that difficult question by expressing an opinion on it.

Mr. TREADWAY. In other words, you are referring that to Mr. Bell?

Mr. OLIPHANT. He will have to decide for himself when you ask him that question.

Mr. TREADWAY. All right, we are giving him an opportunity to get a suggestion as to the line of inquiries that may come his way. I am sure he is very competent to answer them.

The President has suggested something about 620 millions. If we could economize to that extent, we would not need that additional tax money, would we? Is not that logical?

Mr. OLIPHANT. I would like to talk about that if I thought I could add anything to it. I cannot.

Mr. TREADWAY. We got the suggestion in just that form, "Fix it up so that we can get \$620,000,000." You would not care to say whether some of that would be secured by reduction of expenditures?

Mr. OLIPHANT. No.

Mr. TREADWAY. Is it not a fact that there is always a certain amount of waste in the expenditure of large sums of money? What do you think is the percentage of our expenditures, for example, in 1936, that perhaps is being wasted?

Mr. OLIPHANT. I have no idea, because I have no figures on that.

Mr. TREADWAY. It is rather a logical attitude, though, is it not, to feel that in large expenditures there is sure to be waste?

Mr. OLIPHANT. I could agree with a proposition of that generally, even if I did not know where it was going to lead.

Mr. TREADWAY. Representing the administration, do you think that there will still be insistence on the imposition of the processing tax, although the committee has taken that out?

Mr. OLIPHANT. The matters of policy relating to the processing tax as opposed to the matter of its administration, the latter affecting the Bureau of Internal Revenue, are matters in the hands of the Department of Agriculture, and it is in that connection that Chester Davis appeared before the subcommittee and talked about the processing tax.

Mr. TREADWAY. Yes; but whatever talk Mr. Davis favored us with was in executive session, and there was no stenographer present, and it is a good idea to get these things out into the open now to make them a matter of public record.

Mr. OLIPHANT. I should not want to speak—and I believe you will understand my feeling—either for Chester Davis or for the Department of Agriculture.

Mr. TREADWAY. Oh, no; you have a big enough job to speak for the Treasury Department.

Mr. OLIPHANT. Yes; quite.

The CHAIRMAN. The gentleman speaks of insistence on the imposition of the processing tax. I would like to know if he has heard of any insistence from the Administration as to the imposition of any of these taxes, or were they just offered as suggestions for the consideration of the committee for what they were worth?

Mr. OLIPHANT. That is my understanding. The President was discharging his duty in recommending taxes to the Congress, to use the language of the statute.

The CHAIRMAN. At the request of the committee.

Mr. TREADWAY. There is no question but what the committee is absolutely free-handed here to bring in any bill it desires. I would not be a bit surprised but what it is already in print as a result of the recommendations of the Treasury, irrespective of the evidence that may be submitted here.

The CHAIRMAN. The gentleman is so accustomed to that line of procedure he would not be surprised.

Mr. TREADWAY. You brought it on. Let us not get into any argument here this afternoon.

The CHAIRMAN. You brought out the question of insistence.

Mr. TREADWAY. I am not disposed even to dispute you this afternoon, Mr. Chairman.

The CHAIRMAN. You were nevertheless prepared.

Mr. TREADWAY. I would not get into an argument if you did not insist on it.

The CHAIRMAN. I did want to bring out the fact, and I would like to repeat the statement again, that in regard to the processing tax, this corporation tax, or any other tax, if there is a line of any bill in existence, written and sent to the committee, other than what the committee might have requested in order to do the work of the committee as we go, I have never heard of it. I challenge anybody to bring forward one line of evidence that will dispute that statement.

Mr. TREADWAY. Let me recall this instance, if I may, Mr. Chairman. Of course, I am still prepared with inquiries, but is it not a fact—

Mr. DISNEY. Does the gentleman yield there?

Mr. TREADWAY. I am not through. The chairman made his observation to me, and I would like to make an observation before I yield to somebody.

Mr. DISNEY. I wanted to inquire what doctor or professor prepared this list for you?

Mr. TREADWAY. I will stand back of the inquiries I am submitting. There will be no trouble about that along that line.

I want to observe further that some little time ago we were very happy to receive word from the President that he did not expect there would be any tax bill, and then the 3d of March, all of a sudden, we were informed that there would be a tax bill. Then, as the chairman so eloquently stated, it was thrown into the lap of the Ways and Means Committee without the slightest idea, there was not a line on paper or anything in the way of a bill, until suddenly out of mysterious procedure of some kind the suggestions in the Pres-

dent's message were shaped into form by a subcommittee, and it is still right there, I have heard it said.

Of course, this is not open to the criticism that you are rubber-stamping a bill already prepared for us, because all the public has is these few pages, the nine and one-half pages of suggestions. That is as near as the general public knows of any bill. But if a measure is not ready within 24 hours of the time the chairman announces that the hearings are closed, and they are not distributed freely to the committee and to the public in general, I miss my guess.

The CHAIRMAN. You are going to miss it.

Mr. COOPER. Mr. Chairman, will the gentleman yield there?

Mr. TREADWAY. How about continuing our little inquiry back and forth for a while, Mr. Oliphant?

The CHAIRMAN. There has not been any prepared that I have seen.

Mr. TREADWAY. That would not be necessary, Mr. Chairman. You do not need it.

Mr. REED. You recall the time of the alcohol control bill, when it was published in the newspapers before it got to our committee.

Mr. TREADWAY. There was an incident of the same kind. It might have been alike there some way.

Mr. COOPER. Mr. Chairman, will the gentleman now yield?

Mr. TREADWAY. Oh, yes.

By the way, before the gentleman starts, would it not be advisable to make sure how long a time the witness is going to remain on the stand, how long the interruptions must take, rather than proceeding?

The CHAIRMAN. I do not think anybody can tell until we hear the rest of your questions.

Mr. TREADWAY. We certainly cannot tell with the interruptions by the committee, that is certain.

Mr. COOPER. Will the gentleman yield to me for one remark?

Mr. TREADWAY. Oh, yes; but I just wanted to know where we are at.

Mr. COOPER. I just want to ask the gentleman from Massachusetts if he thinks anybody from the executive branch of the Government has sent up to this committee any draft, tentative or otherwise, of this tax bill?

Mr. TREADWAY. It is very peculiar, Mr. Chairman, where all of these bills appear from, and how innocent the committee always is of where the authorship lies, and where it came from, and all that. The gentleman has been on the committee some years, and so have I.

Mr. COOPER. And you have not answered my question.

Mr. TREADWAY. I do not think we are going to get anywhere by arguing back and forth.

Mr. COOPER. You have not answered my question, and you know, yourself—

Mr. TREADWAY. Know what?

Mr. COOPER. That the drafting service of the House of Representatives is the one that will prepare this bill.

Mr. TREADWAY. That will prepare? Have prepared already. That is much better.

Mr. COOPER. You know there has been no draft sent up by the Secretary of the Treasury or any other party.

Mr. TREADWAY. I will accept the gentleman's statement that the drafting service not "will prepare it" but "have prepared it."

The CHAIRMAN. How do you know more about it than any member of the committee?

Mr. TREADWAY. I know from experience.

The CHAIRMAN. But you assert it as a fact.

Mr. TREADWAY. They will have it ready, I still insist, 24 hours after you declare the hearings concluded.

Now, Mr. Chairman, I have not wanted to get provoked.

The CHAIRMAN. You ought not to make remarks like that.

Mr. TREADWAY. I have not intended to show irritation.

Mr. VINSON, Mr. Chairman.

Mr. TREADWAY. Now, Mr. Vinson is coming to reinforce you.

Now, Professor, have you reviewed the estimates of the yield of the taxes proposed by the President?

Mr. OLIPHANT. I have seen Mr. McLeod's figures on that.

Mr. TREADWAY. Did you examine them personally?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. And you approve the estimates?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. You think that Dr. McLeod—he is a doctor also, is he not?

Mr. OLIPHANT. I do not know.

Mr. TREADWAY. Of some kind. You think that his estimates will be borne out by the facts as later developed in the experience of the Treasury Department?

Mr. OLIPHANT. I have no doubt about his competence. The Treasury has to take that risk of estimates it makes, and the Treasury is prepared to take it.

Mr. TREADWAY. What difference is there between the estimates that Mr. McLeod has made and the yield of the taxes as submitted by the subcommittee?

Mr. OLIPHANT. I will have to refer that question to Mr. McLeod.

Mr. TREADWAY. Well, Mr. Helvering made the statement, did he not, that they were not ample, not sufficient. Was not that the statement made, Mr. Commissioner? That is correct, is it not?

Mr. HELVERING. Yes.

Mr. TREADWAY. So that there must be a difference between the subcommittee's report and the figures that the Treasury requested.

Mr. OLIPHANT. Mr. Bell or Mr. McLeod has those figures.

Mr. VINSON. Will the gentleman yield to me?

Mr. TREADWAY. Yes.

Mr. VINSON. The difference was between \$620,000,000 and \$591,000,000 on permanent taxes, and then the other difference was in amount that totaled \$517,000,000 on the temporary taxes for 3 years; but there was no statement by the Commissioner indicating that the estimates were too low, or anything of that kind.

Mr. TREADWAY. The statement that I quoted the Commissioner as making and which he confirmed was that he said the results would be too low.

Mr. VINSON. Oh, no; that is a question of dollars, the difference between \$620,000,000 and \$591,000,000.

Mr. TREADWAY. I agree with the Commissioner's statement.

Mr. VINSON. The Commissioner will bear me out that he made no question—

Mr. TREADWAY. He bore me out, too; so, so far as the bearing out is concerned we are all set. All right.

Mr. VINSON. Let us have no misunderstanding about that. Let the Commissioner speak for himself—

Mr. TREADWAY. He did; he did.

Mr. VINSON. If at any time he questioned the accuracy—

Mr. TREADWAY. He spoke for himself.

Mr. VINSON. Of the estimates submitted here by Mr. McLeod and the Treasury.

The CHAIRMAN. Right there, might it not be interesting, if the gentleman will yield, whether or not he favors increasing the amount so as to come up to the estimate?

Mr. TREADWAY. I will answer that question. I am not in favor of any part of this tax bill and never have been, and do not expect to be.

The CHAIRMAN. Why should you insist on having an argument about it, then?

Mr. TREADWAY. I am not insisting on anything. I am just confirming some things around here.

Mr. VINSON. You are confirming nothing.

Mr. TREADWAY. Let us keep along on an even keel here. You cannot irritate me to save your neck this afternoon.

Mr. DISNEY. Does the gentleman yield on a matter that relates to the present testimony of the witness? Does the gentleman yield to me to ask a question or two?

The CHAIRMAN. Do you yield to the gentleman from Oklahoma?

Mr. TREADWAY. Oh, yes, certainly; go ahead.

Mr. DISNEY. Awhile ago, while you were discussing the curve of receipts showing that in the latter part of 1935 the percentage of tax receipts and income was greater than it had been, our genial friend from Minnesota, Mr. Knutson, inquired of you whether or not those enlarged receipts did not come after the N. R. A. was declared invalid. Is that not correct, Mr. Knutson?

Mr. KNUTSON. I just asked to show how the curve had acted since the Supreme Court had ruled.

Mr. DISNEY. How it went up?

Mr. KNUTSON. The business curve.

Mr. DISNEY. That is what I am talking about.

Mr. KNUTSON. Yes.

Mr. DISNEY. And the impression was that you were rather glad that it was declared unconstitutional. Was not that your impression?

Mr. KNUTSON. How is that?

Mr. DISNEY. Was not that the impression you were trying to give to the committee?

Mr. KNUTSON. I rejoiced to see that measure of freedom returned to the American people; yes.

Mr. DISNEY. I want to refer to the record.

Mr. KNUTSON. I voted for it, if that is what you mean.

Mr. DISNEY. I want to read the illuminating record.

Mr. KNOTSON: I have been praying for forgiveness ever since.

Mr. TREADWAY. Just a moment, Mr. Chairman. The gentleman—

Mr. DISNEY. The gentleman yielded to me, you know.

Mr. TREADWAY. I yielded to the gentleman from Oklahoma for a question.

Mr. DISNEY. Yes.

Mr. TREADWAY. I trust it is germane, because we have heard a good deal about this germaneness.

Mr. DISNEY. Now, Mr. Chairman, adding to that answer of the gentleman from Minnesota, let me read the record on May 26, 1933.

Mr. TREADWAY. Has it anything to do with this tax bill?

Mr. DISNEY. Yes, sir; it does, to the cross-examination by Mr. Knutson.

On May 26, 1933, the following members of the minority voted for the N. R. A., and here is the illuminating record:

Bacharach voted "aye." Crowther voted "aye." Freer voted "aye." Jenkins voted "aye." And, of course, Mr. Knutson will have a witty answer to this, but Mr. Harold Knutson, of Minnesota, voted "aye." Treadway voted "aye." Woodruff voted "aye." Evans voted "aye." Reed was not voting. Cochran, of Pennsylvania voted "no."

Mr. KNOTSON. We have been doing penance ever since.

Mr. DISNEY. I knew you would say something.

Mr. TREADWAY. In addition to that, may I not call the gentleman's attention to the question whether or not that is pertinent to the present line of inquiry?

Mr. DISNEY. Oh, it is as pertinent as some of the things you have asked this afternoon.

Mr. COOPER. More pertinent than most of them.

Mr. TREADWAY. The chairman says for me to go ahead.

Mr. KNOTSON. May I say a moment that when you play with a marked deck you are apt to slip up once in a while.

Mr. VINSON. The gentleman ought not to use that marked deck.

Mr. TREADWAY. You spoke a moment ago, Mr. Oliphant, about Dr. Magill. He was formerly connected with the Treasury. I think you said he had been consulted in connection with this income tax. What was his view of that? Did he favor it?

Mr. OLIPHANT. I wish I felt free to answer it. I do not think I ought to represent his views, do you?

Mr. TREADWAY. It is just as you feel. I would not force you to answer. Very good.

What is the amount proposed to be obtained in the so-called windfall tax?

Mr. OLIPHANT. The estimate on that is—

Mr. TREADWAY. About \$100,000,000?

Mr. OLIPHANT. \$100,000,000.

Mr. TREADWAY. As a professor and student of constitutional law, what would you state to be the constitutional basis for the windfall tax?

Mr. OLIPHANT. It is an income tax and rests on the power of the Federal Government to levy an income tax.

Mr. TREADWAY. Are you confident, then, that the windfall tax would be upheld as constitutional?

Mr. OLIPHANT. I am.

Mr. TREADWAY. Have you any thought as to the amount which it will cost the Government and the taxpayers in the payment and collection of the windfall tax and the litigation of it? Will it be an expensive tax to collect and run down?

Mr. OLIPHANT. Probably Mr. Helvering would be a better judge of that than I am. I think he would be.

Mr. TREADWAY. Do you think it would be pretty expensive?

Mr. OLIPHANT. I do not know. I do not know how it would compare with other comparable taxes from the standpoint of the number of dollars it takes to collect a thousand dollars of a tax. I know that cost will be increased if it is sought after the benefits have been passed farther and farther along.

Mr. CROWTHER. May I interrupt there a little?

Mr. TREADWAY. Certainly.

Mr. CROWTHER. There is really no comparable tax. You say you do not know how it would work in comparison with a comparable tax. There really is no comparable tax to this windfall tax, is there, that we have ever had before?

Mr. OLIPHANT. I suppose you could mark out an area of the Bureau's experience with the processing tax and get some rough idea of what it would cost to administer. They probably would have to, for the purpose of making their requests to the Committee on Appropriations.

Mr. CROWTHER. I think its very name indicates its originality and newness.

Mr. TREADWAY. "Windfall apples" is an old title.

Mr. CROWTHER. They are not good apples.

Mr. TREADWAY. No; they are not good, and this tax is not good.

Mr. OLIPHANT. The basic fairness of the tax remains even though it were baptized under another name.

Mr. TREADWAY. Going from the windfall tax to the corporation tax, are you of the same opinion as to this new corporation tax being constitutional?

Mr. OLIPHANT. I am; yes, sir.

Mr. TREADWAY. According to the President's recommendation, the amounts distributed as dividends would be allowed as deductions in computing statutory income. Is that correct?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. The subcommittee changed this policy somewhat so that the tax is to be imposed upon the statutory net income without deduction for dividends, but the rate is to vary with the percentage of dividends paid. Do you think this change affects in any way the constitutionality of the new proposal?

Mr. OLIPHANT. I do not think it does.

Mr. TREADWAY. It is just as constitutional one way as the other? If one is unconstitutional, the other is?

Mr. OLIPHANT. If one is constitutional, the other is.

Mr. TREADWAY. It works both ways?

Mr. OLIPHANT. I think so.

Mr. TREADWAY. Supposing the Supreme Court should decide that these new proposals were beyond the power of Congress to tax income, what remedies would we have in the future then?

Mr. OLIPHANT. We would be confronted with the same situation if the Supreme Court should declare unconstitutional any of the existing taxes which have not yet been litigated to and through the Supreme Court.

Mr. TREADWAY. So that you are counting on aiding and balancing the Budget with this new money that may be declared an unconstitutional collection again?

Mr. OLIPHANT. Only after satisfying ourselves there is very substantial reason for adopting that course of conduct, of course.

Mr. TREADWAY. Are there precedents for your view that both the windfall and the corporation taxes are constitutional?

Mr. OLIPHANT. Yes; I will be glad to submit a memorandum of law on that.

Mr. TREADWAY. I think it would be quite illuminating if the committee could have those on which you and your associate consultants have based your view that these two new suggested taxes are constitutional. That can be provided, can it, Professor?

Mr. OLIPHANT. Yes; indeed.

Mr. TREADWAY. Just the citation, and whenever it becomes convenient.

Has the Treasury prepared any additional sources of new revenue which we might consider in the event this committee finally determines to impose additional taxes?

Mr. OLIPHANT. As I have stated earlier, the Treasury has done a great deal of work on a great many other types of taxes. There is the possibility of an excess-profits tax, a real excess-profits tax.

Mr. VINSON. Mr. Chairman, I suggest that at this point there be placed in the record the alternative list submitted to the subcommittee as suggestions for revenue.

The CHAIRMAN. Without objection, that may be inserted in the record. I have a copy of this list here. There are nine different suggestions.

(The statement referred to follows:)

POSSIBLE SOURCES OF ADDITIONAL FEDERAL REVENUES

I

The form and character of any additional taxes determine which of the several income groups of our population will chiefly bear the burden of providing the additional revenues.

All excise and processing taxes fall mainly upon the lower income groups. In the fiscal year 1935, 61 percent of the Federal revenues was derived from consumption taxes, inclusive of processing taxes; 55 percent of processing taxes he excluded.

Income and profits taxes fall mainly upon the upper and upper middle income groups of our population; although the reductions in personal exemptions during the depression have increased the direct contributions of the middle and lower middle income groups to the Federal revenues. The substantial increases in the surtax rates applicable to large and very large incomes in the last two revenue acts are, of course, ineffective to the extent that earnings on stocks owned by members of these classes are directly reinvested by corporations, rather than paid out in dividends. Further increases in surtax rates alone in the upper brackets would appear to offer relatively small additional Federal revenues.

It would be possible, of course, to raise substantial revenues by increasing the normal and surtax rates applicable to incomes of \$4,000 to \$25,000 and by further lowering the exemptions and credits for dependents. Such a program would maintain the present escape from high surtaxes that is offered stockholders of corporations which withhold and reinvest, rather than distribute earnings.

In connection with the consideration of possible additional consumption taxes, it is desirable to observe that State and local governments are increasingly turning to such taxes. They face grave administrative, competitive, and economic difficulties in attempts to apply income, profits, and death taxes on a State or local basis. Some 25 States are now collecting general sales taxes, from which their aggregate revenues are expected to reach \$350,000,000 during the fiscal year 1939. In addition, various local governments, such as New York City, are imposing sales and excise taxes of varying scope. New Federal revenues in this field would not only add to the tax burdens of the lower income groups—burdens which are real though indirect—but they would complicate the problems of overlapping and conflicting taxation between the Federal, State, and local governments.

In general, the alternative sources of new revenues for the Federal Government resolve themselves into two groups: Consumption and miscellaneous taxes, and revisions of the income, estate, and inheritance tax laws.

II

Among possibilities of the first group are the following:

(a) *General manufacturers' sales tax.*—A general manufacturers' sales tax of 1, 2, 3, 4, or 5 percent, with items of food, clothing, and medicine exempted.

Estimated Yield

Rate	Yield	Less due to repeal of present manufacturers' excise taxes	Net increase in revenues
1 percent.....	182	\$380,000,000	—198
2 percent.....	364	380,000,000	—16
3 percent.....	546	380,000,000	166
4 percent.....	728	380,000,000	348
5 percent.....	910	380,000,000	530

Such a tax, though productive, would be borne primarily by members of the lower-income groups.

The above estimates assume that the total value of taxable sales does not change as the rate of tax is increased. With the higher rates of tax, it is entirely possible, however, that the total value of taxable sales will be reduced.

(b) *Tobacco taxes.* An increase of 33½ percent in the present tax rates on tobacco and tobacco products, including cigarettes. Estimated yield, \$60,000,000.

Tobacco taxes have proved to be exceptionally productive and exceptionally dependable sources of stable revenue. On the other hand, they are mainly paid, of course, by the lower-income groups.

(c) *Admission taxes.* Reduction of present exemption under the 10-percent admissions tax from 40 cents to 10 cents. Estimated yield, \$80,000,000.

If all tickets costing 11 cents or more were made subject to the present 10-percent tax on admissions, patrons of neighborhood motion-picture theaters and the like would be made subject to the tax. Therefore, the increase in revenues would be obtained largely from the lower-income groups.

(d) *Gasoline tax.* An increase of ½ cent per gallon in the Federal gasoline tax, making the tax 1½ cents per gallon. Estimated yield, \$87,000,000.

Such an increase would probably be opposed by State and local governments, which are relying heavily upon gasoline taxes.

(e) *Check tax.* A tax of 2 cents on each bank check or draft. Estimated yield, \$47,000,000.

Such a tax is commonly classed as a nuisance tax, though productive of revenue and easy to collect.

III. INDIVIDUAL INCOME, ESTATE, AND INHERITANCE TAXES

(1) Reduction in personal exemptions to \$800 for single individuals and \$2,000 for married persons and heads of families. Estimated yield, \$45,000,000.

(2) Normal tax increased from 4 percent to 6 percent. Estimated yield, \$121,000,000.

(3) Surtax rates applicable beginning at \$3,000 instead of \$4,000; rising sharply from 4 percent on surtax net income under \$4,000 to 6 percent between \$4,000 and \$6,000; 8 percent between \$6,000 and \$8,000; 10 percent between \$8,000 and \$10,000; 12 percent between \$10,000 and \$12,000; and there on up to 75 percent on that portion of income in excess of \$5,000,000. Estimated yield, \$226,000,000.

(4) Under an alternative proposal, the surtax rates would begin at surtax net incomes of \$4,000 and rise to 75 percent on that portion of income in excess of \$5,000,000. Estimated yield, \$119,000,000.

If exemptions are reduced, the normal tax rate is increased and the surtax schedule outlined in item 3 above is enacted; the total increased yield is estimated at \$446,000,000.

If the surtax schedule described in item 4 above is adopted, exemptions are lowered and the normal tax rate is increased; the total increased yield is estimated at \$384,000,000.

(5) Special unearned income surtax of 10 percent applying to all unearned income as now defined. Fiscal year 1937, 283.2; fiscal year 1938, 472.

Under the present revenue act, earned income is defined as all compensation received in payment of personal services, up to a maximum of \$14,000; except that no more than 20 percent of the profits of an individual's business enterprise or that derived from a partnership shall be accounted as earned, except, further, that the first \$3,000 of all income is accounted as earned in any case. The present proposal would retain these definitions of earned income. The proposed special surtax would apply, therefore, only to the unearned portions, as thus defined, of an individual's income. The effect of this proposal would be to supplement the present relatively small difference in the rates applicable to unearned as against earned income.

(6) Restriction of deduction of personal exemptions and credits for dependents to normal tax liability, disallowing these exemptions and credits as deductions from surtaxable net income. Fiscal year 1937, 65; fiscal year 1938, 108.3.

This was the practice prior to the Revenue Act of 1934. When these exemptions and credits are allowed for the purpose of determining liability for surtaxes, their effect is to grant much greater relief to recipients of large incomes subject to the higher surtax rates than to those of small incomes. When the exemptions and credits are allowable only in connection with normal tax liability, their value is the same for all taxpayers.

(7) Elimination of present exemption of dividends from normal Federal income tax. Fiscal year 1937, 54; fiscal year 1938, 50.

Dividends received by individuals are now exempt from the 4 percent normal tax applicable to wages, salaries, interest, and other parts of individual incomes. The elimination of this exemption would subject dividends to the same treatment as other parts of an individual's income.

(8) Alteration of present specific exemption of \$10,000 allowed in computing estate taxes so as to retain this exemption in full for estates of \$40,000 or less, to reduce it gradually for estates between \$40,000 and \$80,000, and so as to eliminate it completely for estates in excess of \$80,000. Fiscal year 1937, 31; fiscal year 1938, 53.1.

The present specific exemption of \$10,000 gives much greater relief to beneficiaries of large estates which are subject to higher rates than to those of small estates. The effect of the proposed alteration would be to retain the exemption in full for small estates and to eliminate it for estates in excess of \$80,000. Great Britain grants no specific exemption whatsoever to estates of more than \$500, as compared with the elimination of the exemption at \$80,000 in the present proposal.

(9) Imposition of tax rates identical with those of the individual income tax laws upon all inheritances and gifts received by any individual, except that the first \$10,000 of each inheritance or gift would be exempted from tax by means of a tax credit of \$0.720. Fiscal year 1937, 325.

Mr. TREADWAY. I do not have a copy of that.

Mr. VINSON. You ought to have one.

Mr. COOPER. You were on the subcommittee; you just were not present, that is the only reason you do not know about it.

Mr. TREADWAY. I have already said I did not approve the findings of the subcommittee.

Would you care to discuss the suggestion of the possible adoption of laws along the line of the British system for taxing corporate incomes? Would you mind discussing the present system in general?

Mr. OLIPHANT. I am not prepared to extemporize discussion of the British system of taxation that I would be at all proud of. I would be glad to submit a memorandum of that.

Mr. TREADWAY. We would be glad to have it.

How about a general manufacturers' sales tax?

Mr. OLIPHANT. That has been frequently considered!

Mr. TREADWAY. Oh, yes.

Mr. OLIPHANT. I would be glad to give you a memorandum on that.

Mr. TREADWAY. What are your personal views on it?

Mr. OLIPHANT. I am opposed to it.

Mr. TREADWAY. That is one of the reasons, I suppose, then, that it is not included in the program?

Mr. OLIPHANT. It may be a reason.

Mr. TREADWAY. I suppose you are opposed to all that form of tax, retail turnover tax—

Mr. OLIPHANT. Sales tax.

Mr. TREADWAY. And general sales tax. Why not have a general sales tax just as well as a special sales tax? The taxes we have now are sales taxes, are they not, on many commodities, especially on food, clothing, gasoline, and such things as were exempted in a sales tax bill?

Mr. OLIPHANT. I would not know how to defend, if I were called on to defend, imposing a general sales tax in the face of the two facts that I mentioned, this enormous relative increase in business profits and the avoidance of surtaxes amounting to 620 millions of dollars. In the face of those two facts, I would not know how to go out and defend the imposition of a sales tax, if I had no other objection to the sales tax or what the economists call a tax on consumption.

Mr. TREADWAY. Do you approve of the estimates of the yield of the President's proposal?

Mr. OLIPHANT. I have every confidence in Mr. McLeod's estimates.

Mr. TREADWAY. Would you say that the Treasury has increased increases in corporate expenditures, such as advertising, salaries, and the like, allowable deductions in computing taxes and taxable net income?

Mr. OLIPHANT. Oh, yes; that whole matter of corporate deductions is the subject of constant study in the Treasury. As you know, it generates a great number of problems that are difficult.

Mr. TREADWAY. In other words, it has not been gone into very extensively, then?

Mr. OLIPHANT. Not as the basis of immediate suggestion.

Mr. TREADWAY. What about the ability of large corporations to distribute all their net income each year?

Mr. OLIPHANT. You mean, whether or not they have the ability?

Mr. TREADWAY. Whether they can.

Mr. OLIPHANT. The extent of the earnings distribution, I think we are going to find, if this proposal is adopted by the Congress, is going to depend upon a great many other factors besides the tax. One factor is the habits of the business community. Over long periods of time there is remarkable uniformity in the figures as to the relative amount of earnings that are distributed. Another important factor is that corporations—and I am speaking now of those widely held—have gone to great trouble and great expense in building up their list of stockholders.

The CHAIRMAN. Will the gentleman yield there?

Mr. TREADWAY. Certainly.

The CHAIRMAN. The gentleman refers to the general manufacturers' sales tax. On page 2 of the possible sources of additional Federal revenue, at the top of the page, the general sales tax is referred to as a possibility. It is not recommended, but it is referred to as one of the possibilities by which revenue could be obtained.

Mr. TREADWAY. Oh, certainly; it has always been possible, but I have not seen much enthusiasm on the part of the administration to adopt it.

The CHAIRMAN. I hope you will not.

Mr. TREADWAY. There is a difference of opinion about it.

What, in your opinion, will be the effect on business in general of the adoption of this new scheme of taxation? Do you think it will slacken business in any way or not?

Mr. OLIPHANT. I should not anticipate any radical change in the habits of the business community under this.

Mr. TREADWAY. It will slacken the amount of available capital, will it not, by taking it out of business channels?

Mr. OLIPHANT. The important thing that is going to happen is that about three-fourths of added business earnings, if distributed, would go to taxpayers who pay, including surtaxes, a total individual tax in excess of 15 percent.

Mr. TREADWAY. Are you not inclined to think that instead of going into new business enterprises, people with available capital are going to go to tax-exempt securities?

Mr. OLIPHANT. I think there may be some shift from the stockholder class to the tax-exempt security class. I doubt if that would be substantial, for the reasons that Mr. Kent enumerated.

Insofar as the bill did result in a more substantial distribution of corporate earnings, it might very well prove favorable to the development of new enterprises, because the economists say that a great many businesses have an excess of available funds and resources, and a great many other businesses have a dearth of them.

Insofar as they do go out into the common pool and are reallocated to business generally, it might very well be helpful to new business. I do not know. I think that gets you into the field of theory and speculation.

Mr. TREADWAY. So that there is a possibility that this new tax measure may interfere with the use of new capital?

Mr. OLIPHANT. Favorably.

Mr. TREADWAY. Favorably, you think?

Mr. OLIPHANT. May interfere favorably?

Mr. TREADWAY. It may be either way, though?

Mr. OLIPHANT. Yes.

Mr. TREADWAY. Could you submit from the Treasury the total outstanding tax-exempt securities, and a report on total income-tax returns and State-tax returns covering a period of years?

Mr. OLIPHANT. Yes; I can give you those figures.

Mr. VINSON. Will the gentleman yield?

I think that is in the record at page 248, tax-exempt securities.

Mr. TREADWAY. The list of tax-exempt securities?

Mr. VINSON. Page 248, for States, Territories, and the United States.

Mr. TREADWAY. It has been said that as an average corporations retain 30 percent of their annual earnings and distribute 70 percent, and it is stated that under these circumstances corporations will pay a 15-percent tax, the same rate as they are now paying.

In your opinion, is that average a fair basis, or, or is it admittedly an arbitrary figure too high for some and too low for others?

Mr. OLIPHANT. First let me say a word about that 30 percent.

I pointed out that, of the four billions of added corporate profits which would go to stockholder, about three billions would go to taxpayers having an effective rate on their personal incomes in excess of 15 percent. So that the figures to the effect that corporations keep back 30 percent contain corporations that keep back earnings not for the purposes of business but for the purpose of avoiding the surtax. I have not the figures, but it is my guess that if you could take a census of corporations whose officers were interested in operating the corporation for the purpose of making profits, for the purpose of paying them out to the stockholders, and leave out corporations that were operating investment trusts on the side for reasons having to do with the individual status of some of the officers, you would find that 25 percent is an ample figure as the normal amount of earnings over long periods of time that are retained by corporations (a) for the purpose of expansion, and (b), for the purpose of laying up a reserve against contingencies.

Mr. TREADWAY. What, in your opinion, would be the effect of these new taxes upon the smaller corporations? It has been stated here that the larger corporations, the monopolistic corporations, are liable to favor this, and crowd out the small business corporations. What is your view on that?

Mr. OLIPHANT. That I cannot follow, that this bill would favor monopolistic tendencies.

Mr. TREADWAY. Then you do not think it will injure small corporations?

Mr. OLIPHANT. Speaking as a class, I do not.

Mr. TREADWAY. What about its effect on competition, large and small competitors, for instance?

Mr. OLIPHANT. On that I would entertain the same opinion.

Mr. TREADWAY. How in the future, for the purposes, for example, of expansion, improvement, and replacement of capital equipment, will corporations finance themselves?

Mr. OLIPHANT. Over a long period of time, I think we shall find that corporations will finance themselves in terms of their earning

record and earning prospects. If we in this room now decide to organize a corporation, there is not a dime that we can get to put into it that has not been through the tax mill and paid the surtaxes. I cannot distinguish that situation—I personally; I speak for nobody else—from the situation where a group of men have organized a corporation and failed to provide sufficient capital at the outset, and now want more capital and want a tax bonus in order to enable them to get it.

Mr. KNUTSON. Mr. Oliphant, these corporations would do their refinancing in times of stress, would they not, as a rule?

Mr. OLIPHANT. I beg your pardon?

Mr. KNUTSON. These small corporations would of necessity have to do their refinancing in times of stress?

Mr. OLIPHANT. Many of them would.

Mr. KNUTSON. It is pretty hard to get money from banks during periods of depression, is it not?

Mr. OLIPHANT. Very difficult.

Mr. KNUTSON. How would they finance themselves? For instance, a concern that is losing money steadily, a highly specialized organization with technical workers, would find it to their advantage to hold the organization together, but in order to keep the organization functioning they would either have to have a surplus to work on or they would have to go to the banks and do their financing.

Mr. OLIPHANT. Let me give an example of one company that has been frequently cited in the discussions:

We entered the greatest depression in the history of this country, and I suppose of the Western World, at the close of the period when the corporations had amassed the largest corporate surpluses in the history of the Western World.

Let me point out how that has worked with reference to some corporations.

One corporation frequently cited is the American Telephone & Telegraph Co. The American Telephone & Telegraph Co. during the 10-year period from 1921 to 1930, inclusive, paid out in dividends a total of about 850 millions of dollars.

In the same period they took back in the sale of rights to their stockholders on five different occasions, 925 millions.

Mr. VINSON. 954 millions; it is 104 millions more.

Mr. OLIPHANT. Thereby they provided the cushion.

I will be glad to give you some figures as to other companies, if you would be interested in this connection.

Mr. KNUTSON. Mr. Oliphant, I am more concerned about the small concerns that employ 12, 15, or 20 people, who, of necessity, would have to do their financing at home. They could not go to Chicago if they lived up in Minnesota.

Mr. OLIPHANT. That is right. They could not get in at the front door of the bank in Chicago.

Mr. KNUTSON. The banks have not been lending out any money for the last 3 or 4 years.

Mr. OLIPHANT. Yes.

Mr. KNUTSON. Longer than that.

Mr. OLIPHANT. Yes.

Mr. VINSON. There is no trouble whatever about turning that net income back into the capital?

Mr. OLIPHANT. Not the slightest. I am coming to that.

Mr. KNUTSON. I am speaking now from personal experience.

Mr. OLIPHANT. Of real companies.

Mr. KNUTSON. I am interested in a little company that started laying aside a surplus to erect a new building. The depression came, and they had to dip in and dip in, and their surplus has been used up. But they were able to keep the organization together by reason of the surplus.

Mr. OLIPHANT. A well-managed company.

Mr. KNUTSON. Well, I would say fairly well-managed; yes.

Mr. VINSON. In good hands.

Mr. KNUTSON. But what would happen to that company? Of course they would not have gone under, but they would have laid off, I would say, a third of their help.

Mr. OLIPHANT. I think that is a question calling for a more extended and illuminating answer than I can give, but I will try.

Mr. KNUTSON. Do you not think it calls for more study than we are going to give this proposal at the present time?

Mr. OLIPHANT. No. I think that we have studied that enough. It boils down to a question of policy, which I think I can outline. You have to leave to one side, I think now, if you face your responsibility in the imposition of taxes, very poorly managed corporations. I am talking now about the local corporations.

Mr. VINSON. Mr. Oliphant, will you yield to me for a moment before Mr. Treadway goes?

I move that, on behalf of the majority members of the committee, we extend to Mr. Treadway a vote of thanks.

Mr. TREADWAY. Oh, I do not think that is at all germane to the subject before us, and anyway, I am not going to leave.

Mr. VINSON. I am trying to get at what would happen to the small packer, to use an illustration.

Mr. OLIPHANT. I, too, want to come to grips with that if I can. I think we have to leave to one side the poorly managed or mismanaged corporations, the corporations that we have heard about, the local small corporations, where you find that the president has been taking out \$30,000 a year salary, and the corporations that never paid a dollar in dividends; that type of situation we leave to one side. We are talking about the small corporation, the well-managed corporation.

Under all ordinary circumstances and in all ordinary times, the rates of taxes suggested would make it possible for a corporation to lay back the equivalent of 100 percent of its earnings over the period of 4 years, and that certainly would take care of a great many of the type of corporation that you are properly concerned about at the moment.

Then you have, it seems to me, set aside another large group of these small corporations of the type that you are thinking about. I know many of them out in my country. The typical picture of those corporations is that they are held by relatively small groups.

Mr. KNUTSON. Locally held.

Mr. OLIPHANT. Locally held by a relatively small group who are working together very much on the basis of a partnership, although actually taking the form of a corporation for very substantial business reasons, including limitation of liability, continuity of the firm in case of death, and so on and so forth.

There is a very wide group of corporations of the class that we are discussing right now.

It seems to me you then approach this question of policy, and it is apropos of Mr. Treadway's question to me as to the arbitrary character of an average. The Congress is legislating for the country as a whole; and there comes a point somewhere in making special provisions for special groups where there is danger of jeopardizing the provision that it is making for the country as a whole, losing sight of the forest because of concern about particular trees.

After we have said all that, it boils down to a group of these small corporations that we know about and about which we are concerned, then I have this to say:

I cannot stand here and give you one honest reason for treating any one of these corporations tax-wise in a different fashion than you treat the man next door who is operating as an individual proprietor, or the firm across the street who is operating as a partnership.

Mr. KNUTSON. But, right there, Mr. Oliphant, you know that an individual or a partnership does not have the overhead that a corporation has, as a rule.

Mr. OLIPHANT. I beg your pardon?

Mr. KNUTSON. A partnership or a personally owned company does not have the expense that a corporation has. Take a partnership, two men, we will say, conducting a shoe store. They divide their profits at the end of the year. They do not have, as a rule, the overhead of the corporation. They may have one cheap clerk. But if that were a corporation and a little larger, they would have a much bigger overhead.

Mr. OLIPHANT. I do not quite get that picture in the terms of my own experience, because, of course, across the square from this partnership shoe store is another shoe store, and those men have gone to the local lawyers and underpaid those local lawyers to organize them into a corporation by filing some papers with the Secretary of State, and there is not much difference in their overhead.

Mr. VINSON. Will the gentleman from Minnesota yield?

Mr. KNUTSON. Yes.

Mr. VINSON. I think the gentleman from Minnesota would like to know just how this closely held corporation could get the money which was earned without the payment of the corporate tax.

Mr. KNUTSON. No; that is not what I wanted to know.

Mr. VINSON. I thought you would be interested to know.

Mr. KNUTSON. That is not what I am interested in. What I am interested in is to see that that small corporation—it is a manufacturing concern—is allowed sufficient money to carry through.

Mr. VINSON. Right on that point, assuming it is a closely held corporation such as you have mentioned, a shoe store or a small manufacturing establishment, owned by 6, 8, 10, or 12 people, if 100 per-

cent of the adjusted net income were declared in dividends, the corporation would pay no corporate tax at all under this plan. Then the gentlemen could lend back to the corporation the money, or they could buy more stock, and the corporation could have the money for capital purposes.

Mr. KNUTSON. Yes; but is not this putting a premium on stock issuances?

Mr. VINSON. They would simply have to pay a tax upon the dividends that have been declared, but they could lend the money back to the corporation, every dollar of it, if they wanted to, without the payment of any corporate tax.

Mr. KNUTSON. We will say this, Mr. Vinson, that a depression sets in and everybody has been able to go along for 12 months, but then their surplus becomes depleted and then they have to go to the banks at about the same time all over the United States; then what kind of a strain is that going to put on our banking system?

Mr. OLIPHANT. I think that if in the meantime we have treated everybody alike, so far as the tax burden is concerned, we will be in better shape.

Mr. KNUTSON. You certainly would not treat the small telephone company the same way you would the American Telephone & Telegraph Co., would you? They are not comparable at all. One is financed right up to the chin and the other one barely up to the ankles, if I may use that expression.

Mr. OLIPHANT. That is right.

Mr. McCORMACK. Mr. Knutson, what do you mean by "small", by the expression, "Take this small manufacturing company"?

Mr. KNUTSON. Mr. Oliphant spoke of the American Telephone & Telegraph Co. Now, we will take a small company that is owned locally by, we will say, 100 or 200 subscribers.

Mr. DINGELL. Are not a lot of them mutual companies?

Mr. KNUTSON. No; it is a corporation that has, I think, about 50 or 60 stockholders. How would you treat them, if they had to have a considerable sum of money for replacements right in the midst of depression, when the banks refused to let them have any money—and I do not need to remind you that all these small telephone companies have had considerable difficulty being financed even through the Reconstruction Finance Corporation. The Reconstruction Finance Corporation said that it is not good security.

Mr. DINGELL. Will the gentleman yield for an observation?

Mr. KNUTSON. Yes.

Mr. DINGELL. Does the gentleman know why the small companies could not get money through the Reconstruction Finance Corporation, as far as the telephone companies are concerned?

Mr. KNUTSON. Yes.

Mr. DINGELL. Let me give the gentleman my opinion: It is because they have no investment; they run their wires on barbed-wire fences. They are mutual organizations 99 times out of 100. There is no basis for comparison between the American Telephone & Telegraph Co. and the mutual companies.

Mr. KNUTSON. Maybe they run telephone lines that way up in Detroit, but up in our country they string their wires on poles.

Mr. DINGELL. That is the way they run them in Minnesota.

Mr. KNUTSON. I thank the gentleman for his very valuable contribution.

How would these people finance themselves?

Mr. OLIPHANT. We are talking about a corporation that has earnings, are we not?

Mr. KNUTSON. Let us take a small telephone company. You mentioned the American Telephone & Telegraph Co.

Mr. OLIPHANT. We will take a small telephone company, but we must assume it has earnings; is not that true?

Mr. KNUTSON. More or less; yes.

Mr. OLIPHANT. We must assume that, otherwise they have no tax to pay. So we are dealing with a small telephone company, which in the midst of depression has earnings, and the question is, what sort of tax should you put on that company? Because if it has no earnings, it is in a deficit position and pays no tax.

Mr. KNUTSON. Suppose this telephone line is worth \$100,000 and they have, we will say, 250 subscribers, rural lines. Each subscriber pays \$2 a month, and that is \$6,000 annually. That is 6 percent on a \$100,000 valuation. Where does the replacement come in there?

Mr. McCORMACK. That is deductible under the statute.

Mr. KNUTSON. What I want to find out is what the effect will be on these small corporations that either must have a little surplus on which to enter a depression, or go throw themselves on the mercy of the banks.

Mr. McCORMACK. You know that under this up to \$20,000 on a 50-percent reserve, a small corporation would not pay any more than it does now under the existing law. That is, they could retain nearly a 50-percent reserve on a \$20,000 statutory net income. After the deductions for depreciation, interest charges, and all other statutory deductions, what they could retain for surplus would be pretty close to 50 percent before they would pay the corporation tax they pay now. That is my understanding.

Mr. KNUTSON. Mr. McCormack, why are all the small packers concerned with this legislation? Why do they all express apprehension that after this law has been in effect 2 or 3 years the packing business will be in the hands of the Big Five?

Mr. McCORMACK. Their opposition is on the windfall tax.

Mr. KNUTSON. No; I am talking about reserves. I am not talking about the windfall tax.

Mr. McCORMACK. I did not hear any opposition to the reserves. I heard about the windfall tax.

Mr. TREADWAY. Mr. Oliphant, Professor, there has been a good deal said about large and small corporations. Do you draw any distinction between the two in the sense of efficiency in business and that sort of thing?

Mr. OLIPHANT. For tax purposes, I think it is difficult to draw any distinctions.

Mr. TREADWAY. I had more in mind carrying on the business. I think I can say, without violating the confidences of an executive session, that you made some reference to a distinction between large and small corporations when we were having the subcommittee meetings.

Mr. OLIPHANT. One of the things I said was that I thought that, other things being equal, business profits derived from large corporations and from small corporations ought all to bear the same tax burden—that is, subject to such qualifications as Congress in its wisdom may see fit to incorporate.

Mr. TREADWAY. Assuming that the large corporation could stand the tax better than the small corporation, has the small fellow any preference, in your judgment?

Mr. OLIPHANT. The terms "large corporation" and "small corporation" are not interchangeable with the terms "large stockholder" and "small stockholder"; because there may be small stockholders in large corporations and large stockholders in small corporations.

I think the only safe thing to do is to go back and ask ourselves who pays the taxes. I believe the tax comes out of the individual first or last, and, looking at the individual, I think the only safe rule to apply is that profits from business, by whomsoever derived, whatever his size as a taxpayer, and whatever the size of the corporation, should all bear the same tax burden.

Mr. TREADWAY. We had a good many witnesses that seemed to think they would go broke if this tax is put into effect. Quite a good many testified along that line. You do not agree to that?

Mr. OLIPHANT. I dare say you would have that experience on any tax proposal to raise \$620,000,000.

Mr. TREADWAY. It would hit some of them pretty hard.

Mr. OLIPHANT. I think that is unavoidable.

Mr. TREADWAY. But if it hit the small man, of course, there would be numerous receiverships result if that proves true, would there not?

Mr. OLIPHANT. I am disinclined to think of it in terms of hitting the small man or the big man. Let us say I have a dividend income—which I have not—of \$500, and that it is suddenly doubled. It seems to me I should pay an added tax. My neighbor next door, a widow, lives on nothing but rents. The woman next to her has nothing but some bonds from which she collects interest. The man next door is the principal of the local school, and is getting the same \$90 per month that he got 4 years ago. I think I am the person to pay the added tax rather than those other three, and that is what this does to me, not because anybody objects to my having the added dividend receipts—I assume everybody is glad of it—it merely is because I am more nearly able to do it; I could do it with less hardship to myself and to my family.

Mr. TREADWAY. If the opinion that we have had that it would necessitate borrowing on the part of the smaller corporations is correct, would that give banking institutions an additional hold and control over industry?

Mr. OLIPHANT. Since the typical picture of the small institution, the smaller corporation is that of closely held corporations where the owners know each other, and since there are so many means available for passing those earnings out so that they become subject to tax that everybody else has to pay, and then putting them back, I do not anticipate that hardship to the degree which your question would indicate.

Mr. TREADWAY. What would be your views of the possibilities of another depression coming on, and, no surpluses having been accumu-

lated by business concerns to meet that situation, compared with the industrial business of the country, how could they secure revenue with which to meet the depression? We hope it will not occur, but we have to count on it, have we not?

Mr. OLIPHANT. We have profited and can profit only by our past experience. I can only repeat what I said, that the greatest depression in the history of the country followed the accumulation of the greatest corporate surpluses in the history of the country.

Mr. TREADWAY. Suppose that some of the prophecies should come true, and receiverships and bankruptcies result, with bonds depreciating, banks unwilling to make loans, investment bankers already operating all the businesses they could; in your opinion, would the Government then step in and arrange for the necessary financing by the Government?

Mr. OLIPHANT. I should think that the Government is less likely to have to face that unpleasant alternative if by some fair tax bill of this sort we straighten out that Budget picture.

Mr. TREADWAY. Straighten out the Budget picture?

Mr. OLIPHANT. The Budget picture, as represented in the Budget messages of the President, a bill to replace the taxes that have been lost.

Mr. TREADWAY. Then you maintain still that this is not a bad tax bill; that there are no inequalities or no inequities in it?

Mr. OLIPHANT. I say that it is a tax bill that reduces inequalities and inequities to a minimum. I cannot think of a single tax. I cannot think of a single law but what I dare say you could press me with a particular case where the law was unfortunate. It is not that perfection of fairness to everybody that the Congress can hope to attain. We try, as I see it, and that is certainly the ideal before the Bureau at all times in studying this thing and possible tax legislation, to reduce those hardships and reduce those cases of unfairness to a minimum, not carrying the idea too far, to the point where you lose sight of the mass of the people for whom you are legislating.

Mr. REED. Will the gentleman yield there?

Mr. TREADWAY. Certainly.

Mr. REED. Mr. Oliphant, I just wanted to ask a question. Of course, you have taught economics, I assume?

Mr. OLIPHANT. I have not; no.

Mr. REED. From your teaching of tax law you have undoubtedly examined many, many textbooks on this question of taxing corporate managements. Is it not true that in the great majority of textbooks dealing with corporation finance and management there is pointed out the importance of the corporation's maintaining a sufficient surplus for the so-called rainy day, so that they can make replacements and take care of obsolescence and those things?

Mr. OLIPHANT. The sort of things that are provided for under present tax law. I do not know of any academic writers—of course, I do not know them all, by any means—who would go to the extent of advocating that a corporation ought to be able to add to its capital account for the purpose of expansion or what not without paying the taxes that everybody else has to pay.

Mr. REED. Of course, we are all working for a just and equitable tax, in view of all the circumstances and conditions in which the country finds itself.

We have had a large array of witnesses here, nearly all of whom have pointed out the danger of forcing a board of directors sitting around a table and looking far into the future, each one with a different problem before them, into some special course of action.

There is no use of my trying to enumerate those problems, which run into the hundreds and perhaps into the thousands. They have to approach their problems with business vision and circumspection and all that.

This tax, or a very similar one, as you undoubtedly know, has been tried in Norway, and there people now, after having it in operation for a time, refer to it as an immoral tax. Why? Because it forces a board of directors to adopt a policy that is not considered prudent business management. The result has been that they have suffered from it in the development of their industries; and they have reduced the tax once, and they are endeavoring now to reduce it to 6 percent with the hope, for the good of the country, of removing it altogether.

What I am getting at—I think that we all want to see as good a tax bill as possible—is to be sure that this bill does provide an opportunity for the board of directors to exercise good business judgment in view of all the circumstances, and set aside a surplus and not impose a tax in such a way as will coerce them to follow an unsound business policy, the temptation to which, of course, is very great if they are holding out a surplus and know that they are going to be taxed.

In view of all the circumstances you are prepared to say to this committee, are you, that you believe that the tax bill as laid down here with these proposals will not lead to any such poor business management?

Mr. OLIPHANT. Yes; I agree to that. I am prepared to say that.

Mr. REED. Will you get that far?

Mr. OLIPHANT. Yes.

Mr. REED. In spite of all the testimony that has been offered?

Mr. OLIPHANT. You appreciate that you are asking me a question about almost a half million corporations. You are not, of course, asking me about each and every corporation.

Mr. REED. No; what has been said here repeatedly by those who are advocating this tax is that they have all the time been holding up an average of 30 percent, but you cannot strike an average and have it harmonize with good business judgment. You will agree to that, will you not?

Mr. OLIPHANT. That is true.

Mr. REED. And, if that is true, somebody must suffer?

Mr. OLIPHANT. There will be border-line cases.

Mr. REED. You do not know how many of those border-line cases there will be?

Mr. OLIPHANT. As I see it, that problem of individual hardship is reduced to the minimum. I think the attitude toward business this bill puts the Government in is much more wholesome, because it says,

"Now we are neutral. You can organize a corporation or you can operate as a partnership or you can operate as an individual. The Government is neutral. That is a matter of business judgment."

That is not what our tax law says now, because our present tax law makes it expensive for the little man to use the corporation, and he is the fellow who has to compete with the big corporation.

It makes it highly profitable for the large taxpayer to use the corporation. I think that there is that in this which puts the thing on a more wholesome basis.

Mr. REED. If they fail to exercise the right judgment and maintain the proper amount of surplus in view of the exigencies which may develop in their particular business, they must either go to the banks or they must issue more stock or they must save it out. But if they have not saved out sufficient surplus, is not the bondholder going to suffer as a result of the depletion of capital?

Mr. OLIPHANT. If they do save our earnings, it is added to the capital account, is it not? I say I cannot justify in my own mind additions to capital account by some corporations, when other corporations, if they have to get capital and add to the capital account, have to pay ordinary taxes.

What is underneath all this discussion of the matter of reserves, it seems to me, is this: That you cannot make provisions in this bill for reserves without to that extent granting a tax bonus to the beneficiaries of those provisions.

Mr. REED. The stockholders, of course, are all anxious. They have made an investment in the stock. Your bondholders have lent money to the corporation after careful consideration from all they have. They have lent it on the bonds of the corporation with the expectation that the board of directors are going to exercise prudent and wise judgment.

Would the fact that another country has tried that scheme and found it had worked to the injury of the government and business and worked to the injury of the bondholders and others have any weight with you?

Mr. OLIPHANT. I wish I had the material here.

Mr. REED. I just wanted to get at the facts.

Mr. OLIPHANT. I think you will find there is no unanimity of opinion about the merits.

Mr. REED. You do think we should not proceed in the light of experience of many years? It seems strange to me that we have arrived at a point where a group can sit down and determine in advance just how far the boards of directors of corporations, each with different problems, should be squeezed into one mold by a tax. I think the testimony that has been offered here from business men, basing it on practical experience, would lead us to believe that that is where we are going under this tax bill.

One other point that was brought out by several who testified here was that they were perfectly willing to pay the same amount of tax and pay it to the Government, but do it under the present system, rather than adopt what they believe is an unsound policy.

Mr. OLIPHANT. Of course, that would involve accentuating the inequalities in our present tax on business profits.

Mr. REED. But it would not strike directly at the future prospects and life of the corporations, especially the smaller ones. They would

have discretion to set aside sufficient reserves. The preservation of business and the preservation of pay rolls is fundamental to the Nation, because the Nation's pay rolls are the spending power of the Nation. Everybody has an interest in preserving the corporations because they employ more men.

Mr. OLIPHANT. Certainly wages and salaries are important as a part of the total income which was available for taxation.

The CHAIRMAN. Are you through, Mr. Reed?

Mr. REED. Yes; I am through.

The CHAIRMAN. I would like to ask a question right there in line with Mr. Reed's inquiry.

Is it not a fact that if we impose only such a tax for the support of the Government as those engaged in business as corporations, partnerships, or individuals are able to pay, or would be able to pay without in some way or to some extent crippling their business in time of emergency, would we ever be able to raise enough money to support the Government?

Mr. OLIPHANT. I do not believe so. I believe that criticisms of any tax legislation that might be proposed to raise this amount of money would be substantially the same as in this case.

The CHAIRMAN. This proposal is to pay taxes on net profits. The farmer who owes a tax must pay his taxes regardless of whether he makes a cent or whether he loses. He gets no consideration on that account.

Mr. OLIPHANT. That is right.

The CHAIRMAN. The professional man living in the city who owns a house must pay his municipal taxes, even if he has to mortgage his home to pay them. He is not permitted to lay up out of his salary sufficient to keep his business before he pays his tax. He must pay his taxes.

Why should those engaged in doing business as corporations, where they are required to pay taxes only out of their net earnings after receiving liberal allowances through setting aside and maintaining sufficient reserves to carry them over, be permitted to escape taxes by giving them a low rate of taxation? Do you see any justification of that? I cannot get it through my mind.

Mr. OLIPHANT. I cannot justify talk about provisions for special reserves except within narrow limits for corporations unless we are prepared also to talk about provisions for special reserves for the 1,500,000 partnerships and individual businessmen that there are in this country. I cannot see the difference.

Mr. KNUTSON. Mr. Oliphant, several witnesses for small corporations pointed out that the proposed program would not affect the large corporation which has a large existing surplus to the same extent as it would the small corporation, which has a small existing surplus, if any, since the large corporation can better continue its growth, on the same principle as two corporations of equal size, one obligated to pay indebtedness and the other having no such obligations, are not equally affected by this proposed tax levy. Would you agree with that tax legislation?

Mr. COOPER. Will the gentleman yield there?

Mr. KNUTSON. Yes.

Mr. COOPER. I am sure the gentleman from Minnesota appreciates the fact that large and small is not the controlling point here. It is

the net income, earnings, and profits. It may be a big one or it may be a little one.

Mr. KNUTSON. But supposing the two corporations are practically the same size, and one is obligated to meet certain indebtedness and the other corporation has no such indebtedness? They are not on all fours under this program, are they?

Mr. COOPER. The corporation might make a million dollars one year and the same corporation might make \$10,000 the next year. The amount of tax they pay is measured by their net income, their earnings, and profits. It is not a question of size, large or small. It is a question of their net income, what they make, just like what you and I make.

Mr. KNUTSON. And there is no question as to their indebtedness?

Mr. COOPER. Is there any question about your indebtedness as an individual when the time comes to pay your taxes?

Mr. KNUTSON. Well, I make certain deductions, of course.

Mr. COOPER. Corporations are entitled to make certain deductions, too.

Mr. OLIPHANT. It seems to me the question is addressed not to the bill but to what the Government's tax policy ought to be with reference to indebtedness, whether you are dealing with a corporation or an individual.

Now, let me compare the two corporations concerning whom you just spoke with the man who is operating the drug store on the corner as an individual business. He makes money and he has no debt. The man diagonally across the square is operating a drug store and he has an individual business and makes money but has debts.

I ask, with reference to those two men, if I might, exactly the same question as is asked with reference to these two corporations. That goes to the general question as to what our treatment of debts ought to be. But having decided generally that if you have debts you have to pay your taxes anyway, it seems to me that the safest, fairest, and soundest thing for the Government to do on that is be neutral and treat everybody alike.

Mr. KNUTSON. Would the treatment that the two corporations that I just mentioned receive under this program affect their future expansion? That is, would it give one corporation an advantage over the other in expanding?

Mr. OLIPHANT. Just as it does the two druggists. Suppose those druggists know a drug store in the next county seat which they might buy as the beginning of a little chain. One druggist may be able to do it and the other not. Why? Because we do not allow the ordinary taxpayer to deduct his indebtedness before he pays his taxes. That objection I say is not in criticism of this bill but goes to the more fundamental question as to whether or not indebtedness, like depreciation, ought to be a deductible item in everybody's taxes.

Mr. KNUTSON. Carrying on the interrogation of the gentleman from New York, they have a law like this over in Norway. You probably have heard of that.

Mr. OLIPHANT. Yes; I have heard reports about that.

Mr. KNUTSON. As a result of the operation of a similar law over there, the Norwegians, in going into the market for money with which to expand, lost control of the nitrate industry. It was transferred to London as a result of such a law as we are asked to pass.

Is it not conceivable, Mr. Oliphant, that if the Norwegians lost control of the nitrate plants by being forced to go into the market to borrow money because they were not permitted to carry the surplus that the size of their business necessitated, and is it not fair to assume that the same thing will happen to a lot of small industries in this country?

Mr. OLIPHANT. Was that a small industry?

Mr. KNUTSON. Well, we will say big industries, then.

Mr. OLIPHANT. Then I would like to present these figures, if I may.

Mr. KNUTSON. Let us assume, for the sake of argument, that they are big industries but they have no surplus, and when the time comes and they are going to have heavy demands, they can either go to the banks and lose control of their business or they can issue more watered stock upon which to pay more dividends or they can close down.

That is predicated upon the experience that the Norwegians have had with a similar law. It would seem to me that the Treasury Department should have sent some expert over to Norway and Denmark, where they have such laws, to find out exactly how those laws have operated.

Mr. OLIPHANT. I would like, if I might, in that connection, to present these figures.

Mr. KNUTSON. This is experimental, as far as we are concerned.

Mr. OLIPHANT. I gave the figures on the American Telegraph & Telephone Co. I would like to turn now to the Anaconda Copper Co.

Mr. KNUTSON. Why not take some smaller corporations that have no big bank affiliations? The American Telephone & Telegraph Co. and the Anaconda Copper Mining Co. have shock absorbers and bumpers on all sides. But take a small concern that has to go out and throw itself at the mercy of the banks—take a concern of that size.

Mr. OLIPHANT. Those we discussed earlier in terms that are typical there; they are closely held, and there are numerous methods by which earnings can be put in a position where they will pay the taxes that everybody else has to pay and still continue in business.

Mr. CROWTHER. I think you inadvertently contradicted yourself here a moment ago when you were talking about the equality of taxing on the adjusted net income. We are not taxing them on the adjusted net income under this provision, are we?

Mr. OLIPHANT. I intended to refrain from making a statement on that subject, because I said when it came to a question of schedules and rates I would have to refer those questions to the men more familiar with them.

Mr. CROWTHER. You spoke of the proposition of the equality, or treating them all alike on their undistributed net income. The undistributed net income is used as a base in figuring. Really what we tax them on is what they keep.

Mr. VINSON. You mean the adjusted net income is the base?

Mr. CROWTHER. Yes; the adjusted net income is the base.

Mr. VINSON. And that which is undistributed is the yardstick?

Mr. CROWTHER. Yes; that is the yardstick. Of course, we did not put the figures in here. The figures do not appear here anywhere as to what percentage the tax is of the amount they are able to keep, because they are so distressingly high they do not appear here. You realize that, do you not?

Mr. OLIPHANT. Yes; but we paid—

Mr. CROWTHER. The tax is very high as compared to the amount that they are permitted to keep under this provision. It is very high, is it not?

Mr. OLIPHANT. I say—the matter of the figures—I must frankly refer to the men who have been working on these.

Mr. McCORMACK. These figures are just to show a comparison with the present law?

Mr. CROWTHER. The gentleman knows why they are there just as well as I do. He need not try to explain it now, because I know why they are not here. They would be very disturbing if they were here, when people realize the excessive rate they have to pay, the range of the facts, and what they are able to keep. It is a very disturbing thing.

Mr. McCORMACK. From 10 to 74 percent.

Mr. CROWTHER. Yes; exactly.

Let me ask you this, in all fairness and good faith. I have asked this question several times. "Surplus" is always a cloudy, foggy thing, in some people's minds, is it not? Most people think it is cash in the bank.

Mr. OLIPHANT. That is right.

Mr. CROWTHER. Many times only a very small percentage of it is cash in the bank, is it not?

Mr. OLIPHANT. That is right.

Mr. CROWTHER. What I have been thinking right along is whether or not, if we are going to adopt a policy of this type, do you think it would be any advantage to give a preferential rate to such portion of that as was represented in the building of an addition to a plant or a new plant and equipment during the taxable year? Give them a preferential rate on that portion of the surplus that was represented by that; give them a stimulus to the development of the plant, by giving them a special rate on the amount put into that.

If, say, \$50,000 was put into that, give them a rate of 5 percent, say, on that.

Mr. OLIPHANT. I can speak only from my own convictions, and I seriously question the wisdom of embarking upon a course of subsidies or grants or bonuses via the tax route. If that is going to be done, let us authorize and direct Jesse Jones to do it, so we know exactly how much he is paying out and to whom. That is my personal conviction.

Mr. CROWTHER. You do not think that would be helpful in any way?

Mr. OLIPHANT. No; I would rather have it open and aboveboard as an out-and-out grant, subsidy, or bonus.

Mr. CROWTHER. The taxpayer would have to make a particular showing to the Bureau of Internal Revenue that in the taxable year that much had been spent, this plant had been reproduced or added to during that period.

Mr. VINSON. The gentleman from New York is not suggesting that they be exempted from the payment of taxes?

Mr. CROWTHER. No, no; but at a lower rate.

Mr. LAMNECK. Will the gentleman yield?

Mr. CROWTHER. Yes.

Mr. LAMNECK. I have in mind a corporation that this year spent in plant improvement \$6,000,000 that they had saved up. Under this proposed bill we would penalize them 42.5 percent this year if they

intended to make that improvement. Under the old scheme, after they paid their 15 percent they could do what they pleased with it—build a plant or something else.

I have in mind another corporation that has \$30,000,000 that they are ready and willing to spend as soon as they know what the future business will look like. According to your theory, you would penalize those fellows 42.5 percent if they attempted to keep their earnings in order to accumulate that excess; they could not make the improvement because they did not have the money to do it.

Mr. OLIPHANT. The first corporation you mentioned reminds me of a corporation of which I heard recently that had a mill up in the Pittsburgh district employing 360 men. It held out a substantial part of its earnings and built a new mill which employs 120 men and produces 12 times as much steel. It thereby potentially puts 2,400 men out of work.

Mr. LAMNECK. The corporation I know about employs 20,000, this corporation that spent \$6,000,000. That is the difference.

Mr. CROWTHER. Then you do not think there is any practicable way of working that out?

Mr. OLIPHANT. I am thinking of it in terms of material advantage to productive enterprise. For instance, in the case of heavy industries, where they state most of the unemployment is, should we embark upon a program of special treatment? I personally would be opposed to it.

Mr. CROWTHER. I am not thinking so much of the big ones as I am of the smaller ones down along the line that put half their invested earnings that year into new plant, an addition to the plant that employs 25 more people, and which will, in the long run, if things keep going a little up the line on an upward curve, bring the Government more revenue next year from increased earnings and more employment. You do not think that could be worked out?

Mr. OLIPHANT. I do not think it would be wise to embark upon that sort of a subsidy for new industry.

Mr. CROWTHER. I understand; you have stated that as your personal opinion?

Mr. OLIPHANT. My personal opinion. That is all I can express.

Mr. REED. Mr. Oliphant, do you think that banks ought to be exempt from the plan?

Mr. OLIPHANT. From the fiscal standpoint it does not make much difference since the taxable earnings of the banks as a whole are relatively small.

Mr. REED. If they were exempted, should their shareholders be exempted from the normal tax?

Mr. OLIPHANT. Again reflecting only my own opinion, I would be inclined to restrict the number of exemptions, and, short of statutory requirements with reference to laying aside reserves until the capital and surplus bore a certain ratio to deposits, I would be inclined not to make exceptions.

Mr. TREADWAY. I would like just to conclude, Mr. Oliphant, if I may. It will not take but a moment.

There has been considerable said about new enterprises without much capital, where goodwill, the moral credit, is about all they have. What effect do you think this proposed legislation would have on those people starting in business?

Mr. OLIPHANT. I do not anticipate any serious adverse effects. I should not anticipate any great beneficial effects. I think that is one of those things which may very well just about cancel itself out. Certainly insofar as this led to a wider distribution of current corporate earnings, it would make the total pool of credit available for enterprise much larger.

Mr. TREADWAY. In other words, anyone starting in business would have to be an income receiver to get the money to start with; but assuming they did not have an outside income and these distributions were not going to take place, they are not going to be benefited by it. Then how would they get capital?

Mr. OLIPHANT. Then they are in the same position as anybody else who wants to organize a business.

Mr. TREADWAY. Pretty much out of luck?

Mr. OLIPHANT. And a great many of them are organized every year. A great many of them go out of existence every year. All those people who want to organize a business have available only resources and credits that have been through the tax mill.

Mr. TREADWAY. There has been some expression, too, of rainy-day periods. Supposing these suggestions are adopted, what, in your idea, is the possibility of increased employment when business recessions or rainy-day times come on?

Mr. OLIPHANT. I approach the answer to that question with mixed feelings. In the first place, I do not have the figures to show the extent to which existing surpluses—built up to the greatest, the highest point they have ever been in this country, and immediately preceding the greatest depression we have ever had in this country—have been used for the purpose of maintaining dividends but not for the purpose of maintaining pay rolls.

Mr. TREADWAY. They have been used for both purposes, have they not?

Mr. OLIPHANT. To some extent, certainly, they have been used for that.

Mr. TREADWAY. You say you have the figures showing the extent to which those surpluses have been depreciated during the depression?

Mr. OLIPHANT. I think an analysis would show—here I am becoming pretty speculative because I have not the figures here—that by and large the surpluses were used to maintain dividends as opposed to maintaining total pay rolls.

For instance, if you take the curve of American Telephone & Telegraph Co. dividend payments through the depression, it looks altogether different from the curve of its total pay-roll payments during the depression. They have reduced the number of people they have employed, and they reduced the amount they paid those they did employ.

Mr. DINGELL. One hundred and twenty thousand employees.

Mr. TREADWAY. If this business recession should develop again and companies have not been laying up a surplus in accordance with this proposed law, then it would be necessary, would it not, for them to use the surplus that they are allowed to retain now under this proposed law?

Mr. OLIPHANT. That is right; but, since under the bill it would be possible for them to lay by from 20 to 30 percent of their earnings

each year without having to pay any more taxes than they pay now, I cannot imagine provisions for contingencies—if that is what we are talking about—provisions for contingencies such as depression. I cannot imagine it being sound business judgment to lay that by at the rate of more than 25 percent. It is not the way we take out insurance ordinarily on contingencies and hazards that confront us in the future. To make a 15-percent or 10-percent retention for prudential reasons, if that is what you want to call it, would be very substantial.

Mr. TREADWAY. In the last tax bill we put a graduated tax on corporate incomes, did we not?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. That you are suggesting to repeal in this bill.

Mr. OLIPHANT. That is right.

Mr. TREADWAY. It has not had a chance to be tried out even, has it? It is going to be repealed before it goes into operation?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. Therefore we do not know by experience whether or not that was a good suggestion you made last year. We have had no experience with it, have we?

Mr. OLIPHANT. That is right.

Mr. TREADWAY. What brought about the change in sentiment to discard it before we have put it in operation?

Mr. OLIPHANT. The invalidation of the A. A. A. and the passage of the soldiers' bonus; that is what brought it about.

Mr. VINSON. And the opposition of the gentleman from Massachusetts last year.

Mr. TREADWAY. I prefer to get the answer direct from the witness, with all due respect to my colleague.

I would like to say this, Mr. Chairman: The witness, Professor Oliphant, Dr. Oliphant, Attorney Oliphant, as he is entitled, Mr. Oliphant, at least—

Mr. OLIPHANT. Thank you.

Mr. TREADWAY. Has been extremely courteous and patient, and has exhibited, I think, very general knowledge of the subject of the tax bill that he is backing, and personally I want to thank him for his courtesy to me.

Mr. OLIPHANT. That generous reference to me could come from no one else and have me appreciate it more.

Mr. LAMNECK. Mr. Chairman—

The CHAIRMAN. Mr. Lamneck.

Mr. LAMNECK. Mr. Oliphant, are you particularly interested in raising revenue or are you more interested in having some new tax scheme? Which is your purpose?

Mr. OLIPHANT. Solely interested in raising revenue with the least hardship.

Mr. LAMNECK. How much money will the corporations pay under this bill? I mean, how much increase will they pay over this bill?

Mr. OLIPHANT. When you get to the matter of figures—

Mr. LAMNECK. I would like to have some expert answer it: How much more will the corporations pay under this bill than the old set-up? Who can answer it?

Mr. McLEOD. \$620,000,000.

Mr. LAMNECK. No; that is not correct. I want to know how much more the corporations are paying under this bill than they are under the present bill.

Mr. OLIPHANT. Is that how much more comes from the business profits or is paid by corporations?

Mr. LAMNECK. Corporation earnings, taxes.

Mr. VINSON. At the present time, to get it down concretely, corporations are paying about \$1,100,000,000.

Mr. LAMNECK. I did not ask that.

Mr. VINSON. I am trying to get down what you want, because you are asking a real question. That is correct, is it not, Mr. McLeod?

Mr. LAMNECK. How much?

Mr. VINSON. About \$1,100,000,000. The stockholders are paying about \$1,100,000,000. There will be an increase in the taxes paid by the stockholders.

Mr. LAMNECK. Of how much?

Mr. VINSON. That is what you want to know; you want to break down this \$620,000,000.

Mr. LAMNECK. \$591,000,000.

Mr. VINSON. \$591,000,000. In my opinion, it may be \$620,000,000. You can call it \$591,000,000 if you want to. What you want to do is to divide up your \$591,000,000 or my \$620,000,000 between individual's income-tax returns and corporations.

Mr. LAMNECK. That is exactly what I want. Who can give me that information?

Mr. McLEOD. Of course, that figure will depend upon the actual amount the corporation has retained.

Mr. LAMNECK. You have made an estimate of how much they are going to retain. You said they are going to retain 30 or 35 percent. Let us proceed on that basis.

Mr. McLEOD. All right, I will give you that figure.

Mr. VINSON. While he is figuring it, could I ask Mr. Oliphant a question?

Mr. LAMNECK. Yes.

Mr. VINSON. Mr. Oliphant, in regard to the small corporation closely held, I ask if this is not a fact:

If a corporation owned by four individuals were to have an adjusted net income of \$10,000 a year, they could declare the entire net adjusted income out in dividends, divide it up \$2,500 per person, and pay a much lesser rate individually than the corporation would pay under existing law?

Mr. OLIPHANT. That is right.

Mr. VINSON. In other words, under existing law the rate would be \$1,250, \$1,500?

Mr. OLIPHANT. That is right.

Mr. VINSON. That would be paid by them to the corporation, but just as effectually paid by them?

Mr. OLIPHANT. That is right; it comes out of their pocketbook in the long run.

Mr. VINSON. And if full distribution is made, they would pay the appropriate income-tax rate?

Mr. OLIPHANT. That is right.

Mr. VINSON. And they can turn back into the corporation, either through a loan or through the purchase of stock, such proportion of the \$10,000 as they see fit?

Mr. OLIPHANT. That is right.

Mr. VINSON. Of course, that would apply to corporations of larger income and with a larger number of stockholders with a decreased income-tax rate per individual stockholder?

Mr. OLIPHANT. That is right.

Mr. LAMNECK. You say under the new bill there would never be a corporation capital levy, is that right?

Mr. OLIPHANT. What I said was, there were four sources from which people can pay taxes, if you left to one side taking a part of their capital.

Mr. LAMNECK. But you did say that there is no conditions that could arise that would mean a capital levy against a corporation?

Mr. OLIPHANT. If you are asking, would this tax bill ever in its operation call on a corporation to pay something more than what it had out of its then current earnings—is that your question?

Mr. LAMNECK. Yes.

Mr. OLIPHANT. I never made any such statement; no.

Mr. LAMNECK. You did not?

Mr. OLIPHANT. No. What I tried to say was that it seems to me that this bill goes as far as you can go in the matter of reducing to a minimum those individual cases of hardships, and so forth. I daresay you will find individual cases of hardship where that is true, just as it is true under existing law you and I are taxed the same rate so far as our income tax is concerned, but I may have a sick wife and three sick children, and the hardship may be enormously different.

Mr. LAMNECK. Suppose I made a million dollars in business, and I was obligated to pay the bank on the 1st of September, \$700,000. The Government would levy 42.5 percent of \$425,000. I would then pay a capital levy, would I not?

Mr. OLIPHANT. The Government would levy on your entire earnings, that is right.

Mr. LAMNECK. In other words, I would pay \$125,000 more than I earned?

Mr. OLIPHANT. You would then take your loss, including your tax.

Mr. LAMNECK. And it would be a capital levy?

Mr. OLIPHANT. It would decrease your total capital, if I follow you.

Mr. LAMNECK. It would be a capital levy, then, would it not?

The argument has been made here that the present tax law discriminates against partnerships. There are 214,000 corporations having an income of less than \$10,000; is that right?

Mr. OLIPHANT. I think that is substantially the figure.

Mr. LAMNECK. If they were partnerships, their taxes would be less than they are under the corporation form?

Mr. OLIPHANT. Other things being equal, that is true.

Mr. LAMNECK. Has not the argument of it been that the reason you want a new tax law is because we have been discriminating

against individuals and partnerships, in 214,000 corporations out of 257,000? That is not true, is it?

Mr. OLIPHANT. I do not follow that. Frankly, I just do not follow it.

Mr. LAMNECK. The 214,000 have earnings less than \$10,000?

Mr. OLIPHANT. Yes.

Mr. LAMNECK. The partnerships would pay less taxes under the same conditions if they were partnerships than these 214,000 do as corporations?

Mr. OLIPHANT. Suppose there were that number of partners, so that each one paid the normal 4 percent.

Mr. LAMNECK. You are talking about individuals.

Mr. OLIPHANT. Yes.

Mr. LAMNECK. I am not talking about individuals; I am talking about partnerships where you would have to have two or more; so the whole argument has been that the present law discriminates against partnerships. It does not to the extent of 214,000 corporations, anyhow, does it?

Mr. OLIPHANT. I do not follow that.

Mr. LAMNECK. All right. Now, can the expert here give me the amount of money to be raised under the suggested law?

I want to ask this question:

You said that the rate to raise an equal amount of revenue would have to be 25.5 percent, if we raised revenue at the present rate. My figures are that you collect at the present time \$591,000,000 from corporations, and under the new law, the proposed law, you will collect \$328,000,000.

Mr. OLIPHANT. I did not get your first figure.

Mr. LAMNECK. Under the present law we are collecting \$591,000,000 from corporations.

Mr. OLIPHANT. Let us get that figure. What is the amount now being collected from corporations?

Mr. LAMNECK. No; let me put it this way; I am wrong about that: The increase collected, according to your figures, under the new set-up, will be \$591,000,000. The amount collected from corporations, the increase under the new scheme, is \$328,000,000.

Therefore, you would only have to increase the rate from its present rate less than 22 percent to raise the \$328,000,000.

Mr. OLIPHANT. As I said to you, when you get into figures you get me beyond my depth. I am advised by the statistical staff of the Treasury Department that makes the estimates that 25.5 percent would be necessary.

Mr. LAMNECK. What I am coming to is, as an expert and as an adviser of the Treasury, would you object seriously to an increase in the present rate that would raise the same amount of money that you are now asking for? Would you object seriously to that kind of a bill?

Mr. OLIPHANT. I do not think that is wise. Whether or not a thing is wise or unwise is always a relative matter, is it not, as compared with something else? I do not think that is nearly as desirable a course to pursue as the one before the committee.

Mr. LAMNECK. There is a lot of difference, though, to a business man. He can use his surplus under that suggestion in the way he

pleases, but you are telling him how to use it under this new law, are you not?

Mr. OLIPHANT. We are trying not to.

Mr. LAMNECK. You are forcing him by a penalty tax, even though he does not want to, to do what you want him to do?

Mr. OLIPHANT. No.

Mr. LAMNECK. What is true?

Mr. OLIPHANT. As I stated at the outset, it is my position that it is for the officers of the corporation to determine whether or not they are going to distribute earnings and how much they are going to distribute. That is none of the Government's business.

Mr. LAMNECK. You say if they do not do what you provide in this bill, then you are going to penalize them. Do you not say that in this bill?

Mr. OLIPHANT. No. If I can finish the statement, that is none of the Government's business, but it is the Government's business that they shall not use the corporation or permit others to use the corporation as a device for avoiding surtaxes which everybody else has to pay.

Mr. LAMNECK. Let me ask you another question as a tax expert:

Here is a company which in 5 years throughout the depression lost \$12,000,000. They are a good concern, still doing business. Do you think they ought to be penalized to the extent of 42.5 percent to rebuild that capital structure to where it was in 1929?

Mr. OLIPHANT. No; and I do not think they ought to be subsidized in order to rebuild it. That is the way it appears to me.

Mr. LAMNECK. You do penalize them under this bill, do you not?

Mr. OLIPHANT. If \$1,000,000,000 of the \$4,000,000,000 added income going to individuals, if corporate earnings are distributed, is income that would go to people that would pay a total rate of more than 15 percent on their income, and you asked everybody else to pay the same surtaxes on business profits, you are not penalizing anybody; you are just declining to grant a bonus.

Mr. LAMNECK. Do you have those figures?

Mr. McLEOD. I have; yes.

Mr. LAMNECK. All right.

Mr. McLEOD. Under the proposed bill the corporations would pay a tax of \$1,065,000,000. Under the present law they pay \$1,132,000,000.

Mr. LAMNECK. The corporations will pay less under the new bill?

Mr. McLEOD. That is right; assuming you have in the old bill a capital stock tax, an excess profits tax and an income tax. The capital stock tax and the excess profits tax will be repealed. Then you will have a flat rate of tax on the total corporate income depending on the amount they retained, say, 30 percent. That means they would be paying a 15-percent rate of tax on the total corporate income.

Mr. LAMNECK. In that event you would not raise as much money under the new bill as you do now under the old?

Mr. McLEOD. Under that law, because of the 70 percent that they paid out, we would raise in the individual income taxes, \$1,811,000,000.

Mr. CROWTHER. How do you know that?

Mr. LAMNECK. Wait; let him finish this question—\$1,811,000,000. Under the present law, what do you raise?

Mr. McLEOD. Under individuals?

Mr. LAMNECK. Yes.

Mr. McLEOD. \$1,153,000,000.

Mr. LAMNECK. In other words, you have raised from individuals the difference, about \$650,000,000, is that correct?

Mr. McLEOD. You would raise from the individuals the difference between \$1,153,000,000 and \$1,811,000,000.

Mr. LAMNECK. That is \$658,000,000, is that right?

Mr. McLEOD. That is right.

Mr. LAMNECK. The argument was made that this new bill in distributing corporate funds would put a lot of purchasing power in the hands of the individual taxpayer. Is that right?

Mr. OLIPHANT. I did not make that argument. I do not know whether anybody made it on behalf of the Treasury.

Mr. LAMNECK. If that was true, if that has been the argument—and I am sure it was; it has been repeated many times—we immediately proceed to take \$658,000,000 away from them?

Mr. OLIPHANT. The man who sponsors that argument will have to take the responsibility for it. Nobody made that on behalf of the Treasury Department. This is not a reform bill; this is a tax bill.

Mr. LAMNECK. That is a fact, that you really take \$658,000,000 away from the individual taxpayer that he could spend on a lot of things under the present bill?

The CHAIRMAN. That is based on the income that he gets from increased dividends. He would certainly have more money, or else he could not pay that tax.

Mr. LAMNECK. You take \$658,000,000 away from him the minute that tax is applied.

The CHAIRMAN. But that is a percentage of his increased income.

Mr. VINSON. I am told here that that \$658,000,000 tax, additional tax, paid by the individual, is based upon an adequate income to individuals of \$4,800,000,000, and consequently the individual would have substantially \$4,142,000,000 more than he would have under existing law.

Mr. CROWTHER. I would like to say, if I can get the answer to my question, on what is that based that they are going to get that much money from the distributees? Does the Treasury Department know how many individual taxpayers are above the 15-percent line that Mr. Oliphant speaks of that are stockholders? Have they the list of stockholders that are at that figure?

Mr. McLEOD. We have the list of stockholders who reported dividends in the preceding year by their income brackets, and we have it for several preceding years. We have the dividend history of corporations and individuals, and have received those for many years.

Mr. CROWTHER. I am glad that there is something actual about this information; but I still hold to the point I made earlier—that while you may possibly get the money this year, you will never get it another year, because the people will not pay that measure of taxation, and they will seek other avenues for their speculation and for their investments. You will never get it a second year.

Mr. McCORMACK. You made reference to being opposed to the general manufacturers' excise tax. You mean as between these matters which are before the committee now? Is that true?

Mr. OLIPHANT. That is it.

Mr. McCORMACK. In other words, if you had to go into excise matters, would you not rather have a general manufacturers' excise tax with the necessities of life exempt than a processing tax?

Mr. OLIPHANT. I want to refer questions of policy relating to the processing tax to the Department it concerns.

Mr. McCORMACK. I am just asking you. No department enters into this. Would you rather have a general manufacturers' excise tax, in the event we had to go to it, in preference to the processing tax?

Mr. OLIPHANT. I would be embarrassed by drawing any such invidious distinction.

Mr. McCORMACK. I am just asking you a question of opinion.

Mr. OLIPHANT. I can see plenty of circumstances if the situation were desperate enough when we should go to taxes on consumption as well as the manufacturers'.

Mr. McCORMACK. As between the tax on food, which the processing taxes are, would you not much prefer to have the general manufacturers' excise tax, with necessities of life exempted from that?

Mr. OLIPHANT. I would much prefer not to express an opinion on that, if I might be excused.

Mr. McCORMACK. Not even a personal opinion?

Mr. OLIPHANT. That is right.

Mr. McCORMACK. In other words, I wanted to get your state of mind, that you are not completely and absolutely opposed to the general manufacturers' excise tax, but only under the present situation you prefer these methods to that?

Mr. OLIPHANT. That is right. What I say is that when you have an opportunity to choose—

Mr. McCORMACK. I only ask you these because at some future hearings you might be quoted and your state of mind might not be completely understood.

The CHAIRMAN. I do not think any of us who are opposed to the manufacturers' sales tax might not under some emergency submit to them temporarily.

Mr. McCORMACK. Mr. Chairman, I just want to ask Mr. Kent a question, if I might.

Mr. HILL. Are you through with this witness?

Mr. McCORMACK. If they are through with Mr. Oliphant. I do not want to do that if any member of the committee has any more questions of Mr. Oliphant.

Mr. VINSON. Will the gentleman yield to me?

Mr. HILL. Mr. Vinson.

Mr. VINSON. Mr. McLeod gave me the figure of \$4,800,000,000 that would go to individual stockholders. That was based, I ought to have realized, upon 100 percent distribution.

The \$4,800,000,000 was 100 percent distribution. The 70 percent distribution would be \$3,360,000,000 to individual shareholders.

Mr. CROWTHER. That is just the same sum we appropriated for relief last year, was it not, \$4,800,000,000?

Mr. VINSON. That would be \$2,702,000,000 more than the \$658,000,000 involved in the tax.

Mr. McCORMACK. If you are all through, I would like to ask Mr. Kent a few questions.

The CHAIRMAN. We thank you for your appearance and the testimony you have given the committee, and also thank Mr. Treadway for his help in bringing you here to give this fine support to the bill.

Mr. OLIPHANT. I appreciate your kindness and consideration.

FURTHER STATEMENT OF ARTHUR H. KENT

Mr. McCORMACK. Somebody representing the American Transit Association—they have offices here in Washington—called to see me the other day and called to my attention the fact that when we removed the consolidated return except as to railroads the provision was not left permitting it to apply to street, suburban, or interurban electric railways.

Mr. KENT. That is right.

Mr. McCORMACK. That the Department, naturally following the language used, has reached the decision that they are not entitled to file a consolidated return. Is that right?

Mr. KENT. That is right.

Mr. McCORMACK. Do you know of any objection to their being permitted to file a consolidated return?

Mr. KENT. No; I do not. It was just a question of statutory interpretation, that was all.

Mr. McCORMACK. That was the information I received, and I just wanted to get your viewpoint and the viewpoint of the Department and put it in the record so the committee could consider it in executive sessions.

Is there any reason, also, why they should not be given the same consideration that railroads are with reference to rates, and so forth?

Mr. KENT. I think not.

Mr. McCORMACK. I will read into the record a suggested amendment so that the Department can consider it. This amendment was left in my office:

Section 141, at the end of subparagraph (d), after the word "dividends" strike out the period, insert a semicolon, and add the following: "and the term 'common carrier by railroad' includes street, suburban, and interurban electric railways."

I put that language in the record so you gentlemen can consider it. In view of your answers, I do not think there will be any doubt but what the matter will be taken care of.

That is all.

Mr. VINSON. Mr. Chairman, at this point I would like to put in the record a chart with reference to the tax burden, national and local, headed, "Nation collects 23 percent, local gets 77."

It shows the ratio which the national and local taxes in percentage in Belgium, Poland, the United Kingdom, Italy, France, Sweden, Japan, Germany, Canada, and the United States for the years 1932 and 1933.

This chart represents a comparison of the tax-raising systems of the United States and foreign countries. The bars show the ratio of national to local tax revenues for each country during 1932-33.

Approximately 80 percent of the revenues of England, Belgium, Italy, and Poland are raised by the central government. The national revenue is derived in most countries by a combination of income taxes, inheritances, business, excise, and customs taxes.

In the United States during 1932-33, the Federal Government raised only 23 percent of the total revenue, while State and local authorities raised 77 percent.

The CHAIRMAN. Without objection, the statement may be inserted in the record.

(The chart referred to is on file with the committee.)

Mr. OLIPHANT. I neglected to put in the record, as I intended to do, a brief statement of the history of this general tax plan, beginning on June 30, 1864, and extending down to date.

(The statement referred to is as follows:)

BRIEF HISTORY OF TREATMENT OF BUSINESS INCOME AND OF ATTEMPTS TO PREVENT THE ESCAPE OF TAXES THROUGH THE RETENTION OF CORPORATION EARNINGS

The President's proposed tax on undivided corporation profits revives a problem which has had the attention of Congress, of the Treasury, and of students of taxation for over a generation. Indeed, even in the earliest period of Federal income taxes (1862-71) consideration appears to have been given to this problem for, beginning with the act of June 30, 1864, Congress provided that the gains and profits of corporations should be included in the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise.

With the advent of the modern income taxes in 1913, a provision to prevent the evasion of surtaxes through the use of corporations was introduced in the 1913 act, and was continued without substantial change in the Revenue Acts of 1916 and 1918. These acts provided for an addition to the dividend income of the stockholders of a corporation which for the purpose of evading surtaxes accumulated profits beyond the reasonable needs of the business, and the taxes of the stockholders were thus determined as if distribution had actually been made.

Shortly before and while the Revenue Act of 1921 was under consideration, the problem received much attention in Congress, by the Treasury, and by representatives of organized business. At that time the repeal of the excess-profits tax was being considered and the opinion was widely held that some measure should be adopted to maintain the substantial balance which had existed during the period of the war taxes when individual and corporate business enterprises alike were taxed at high rates.

Secretary Houston in his Annual Report for the year 1920 recommended substituting for the then existing graduated rates, a flat tax on profits in excess of distributed earnings. The object of this proposal, he said, was "to establish, so far as possible, an exact equivalence between the taxation of corporation stockholders and other taxpayers."

So eminent an authority as the late Dr. T. S. Adams, former chairman of the Advisory Tax Board in the Bureau of Internal Revenue and for many years a Treasury adviser, as early as 1918 went on record in favor of the taxation of undivided profits at the rates which would apply if such profits were distributed to the shareholders. "Fiscal necessity—and, personally, I believe, logic as well," said Dr. Adams, "requires the taxation of all profits, whether reinvested or not." The same thought was behind his recommendation in 1920 to the second national industrial tax conference that the corporation income tax be raised from 10 to 16 percent, and his proposal in substance became a part of the majority report of the conference board's tax committee.

Before the Senate Committee on Finance in the first session of the Sixty-seventh Congress, the National Association of Credit Men proposed that there should be no tax upon corporation income that is distributed, and opposed the flat corporation tax on the ground that it discriminated against small shareholders and violated the principle of taxing the individual in accordance with ability to pay. A similar proposal was made to the same committee by Mr. Frank H. Seidman, a leading accountant and tax expert of New York, Chicago, and Grand Rapids, and Senator Jones of New Mexico introduced an amendment to the 1921 tax bill substantially along the lines recommended by the Association of Retail Credit Men. As finally enacted, the Revenue Act of 1921 contained only a flat tax on corporation income at the low rate of 10 percent for the year 1921 and 12½ percent for succeeding years, while the maximum individual surtax continued through 1921 at 65 percent and thereafter at 50 percent.

However, Congress recognized that the importance of the problem called for some kind of legislative action. The result was section 220 of the Revenue Act of 1921, which imposed a surtax of 25 percent on any corporation "formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders." In 1924 the rate of tax was increased to 50 percent, which rate was continued in the law until the Revenue Act of 1934. Section 102 of the Revenue Act of 1934 is substantially the same as the earlier sections, except that the rate of tax is reduced to 25 percent and the tax is levied on net income less dividends and taxes paid out rather than on the entire net income.

In 1926-27 the Joint Committee on Internal Revenue Taxation made a careful study of the problem from the point of view of our experience and that in Great Britain, but failed to recommend a tax on undivided profits because of the fear that it might cause "unwise distributions and prevent the accumulation of a reasonable and proper surplus." It recommended instead the granting of a deduction to encourage distribution of unneeded surplus. The committee, however, apparently was influenced by the fact that at that time the maximum individual surtax rate was only 20 percent, while the corporation rate was 13½ percent.

The measures adopted by Congress to prevent evasion of the surtaxes proved to be difficult to administer and were generally ineffective. This led Congress in the 1934 act to impose a straight tax on personal holding companies, which were among the worst offenders, in which no proof of intention to evade was required. These companies are now taxed on their undistributed earnings in excess of 20 percent at rates running up to 60 percent on amounts in excess of \$1,000,000.

In the 1932 act the surtaxes were increased to 35 percent, while the flat corporation rate was raised only to 13½ percent. This disparity between the individual and corporation rates brought into sharp relief the fundamental inequity of our treatment of individual business enterprises, as well as the unfairness to the small stockholder, and early in the Roosevelt administration intensive studies were undertaken by the Treasury, whose experts, with the cooperation of outside consultants, considered the problem from every angle. While the unusual demands for revenue may have been the immediate reason for the President's proposal, the problem itself is as old as the income taxes and has had the consideration of some of the ablest students of taxation.

Mr. KNUTSON. Mr. Oliphant, I have just one question: You will concede that the higher the taxes, the lower the living level?

Mr. OLIPHANT. I cannot think that all through in a minute.

Mr. KNUTSON. What I am trying to get at is, the more money we pay the tax collector, the less we will have for the necessities of life!

Mr. OLIPHANT. That might depend on what the tax collector did with it. I do not know.

Mr. VINSON. I suggest that if the taxpayer gets more money in dividends under this plan, \$2,702,000,000 more than he pays out in taxes, it ought to increase his standard of living.

The CHAIRMAN. At this point we will adjourn until 10 o'clock in the morning.

We expected to conclude today, but this witness was on the stand longer than we expected.

We will come back tomorrow morning at 10 o'clock, with Mr. Bell, Director of the Budget, as the first witness. We certainly expect to close tomorrow without having a night session.

(Whereupon, at 6 p. m., the committee adjourned until 10 a. m., Tuesday, Apr. 7, 1936.)

April 8, 1938

55

Practical Examples of the Operation of the Proposed Corporation Tax as Compared with the Existing Federal Corporation Taxes

Nearly all corporations will pay smaller Federal corporation taxes under the proposed bill than they pay at present. This is true because all corporate earnings, whether distributed or not, are now subject to a corporation income tax of 12½ to 15 percent, as well as capital stock and excess profits taxes; while under the proposed plan the amount of tax will be determined by the percentage of net earnings transferred to surplus. Any corporation that distributes all of its current earnings will pay no Federal corporation taxes whatever under the proposed plan (with the exception of a temporary tax on capital stock); and even those corporations that transfer to surplus up to 30 percent of their earnings (40 percent for small corporations) will pay smaller taxes under the proposed plan than they pay now.

The best way to bring this out is to cite a number of specific examples. Because of the temporary character of the proposed capital stock tax, it has not been included in the calculation of corporation taxes under the proposed plan.

I

Here is a large manufacturing corporation with net earnings, before Federal taxes, of \$25 millions. We will assume that the declared value of the capital stock of this corporation is ten times its net earnings, or \$250 millions.

Under the present law, this corporation would pay the following taxes to the Federal Government:

Capital stock tax at \$1.40 per thousand	\$ 350,000
Excess profits tax	0
Corporation income tax	3,596,940
Total	\$4,046,940

Under the proposed plan, this corporation would pay no taxes whatever if it paid out all of its earnings in dividends. If it decided to retain for contingency reserves or to add to its surplus an amount equal to 20 percent of its annual earnings, corporation taxes under the proposed plan would amount to \$2,250,000, or a little more than half of its present Federal taxes.

If this corporation thought it necessary to retain 30 percent of its current earnings, the tax would amount to \$3,750,000, or \$296,940 less than would be paid under the present law. It should be emphasized that there would be no tax whatever in connection with legitimate reserves withheld out of gross earnings for depreciation and depletion.

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II

Here is an incorporated automobile dealer in a small city, whose invested capital is \$20,000, but who, in order to minimize his excess profits tax, files a declared value of his capital stock at \$40,000. This dealer's corporation reports earnings, before Federal taxes but after all salaries and allowance for depreciation, of \$5,000.

Under the present law, this corporation would pay the following taxes to the Federal Government:

Capital stock tax at \$1.40 per thousand	\$ 56.00
Excess profits tax	56.64
Corporation income tax	<u>632.72</u>
Total	\$745.36

Under the proposed plan, the corporation owned by this automobile dealer and his family would pay no Federal corporation taxes whatever if it paid out all of its earnings in dividends. If it decided to reinvest in the business an amount equal to 40 percent of its year's earnings, the total Federal corporation taxes under the proposed plan would amount to \$650, or \$95.36 less than under the present law. In other words, this dealer could employ 40 percent of his earnings for expansion or for the retirement of bank or mortgage indebtedness; pay the proposed tax on the amount so employed; and still be better off than he is under the present law.

III

Here is a corporation whose principal asset consists of an apartment house built in 1928 at a cost for land and building of \$200,000. The property is subject to a first mortgage of \$100,000 which secures the corporation's 6 percent bonds of like amount. The directors and stockholders of the corporation had hoped to realize a net return of 10 percent, or \$20,000, on the total invested capital of \$200,000. After paying \$6,000 of bond interest, they hoped to have left \$14,000 which would yield them a return of 14 percent on their invested capital of \$100,000. To avoid paying an excess profits tax, they reported a declared value of \$140,000 for their capital stock.

At the present time, however, the net return on the total investment is only \$10,000, out of which the corporation must pay \$6,000 bond interest; leaving net profits of \$4,000 per annum.

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The indenture of the bond issue calls for the retirement each year of \$4,000 principal amount of bonds. However, in computing its income for tax purposes, the corporation has naturally deducted a depreciation allowance of from 2 to 3 percent on the total investment. Let us assume that the lower figure has been used, in which case the corporation, in addition to its \$4,000 of net earnings, has an additional \$4,000 available for bond retirement from its depreciation reserves.

Under the present law, this corporation pays the following taxes to the Federal Government:

Capital stock tax at \$1.40 per thousand	\$196.00
Excess profits tax	0.00
Corporation income tax	<u>484.52</u>
Total	\$680.52

Under the proposed plan, this corporation would pay no Federal taxes whatever if all of its earnings were distributed in dividends. Further, if the owners of the corporation desired to retire an additional \$4,000 of bonds with these earnings, they would find it profitable to pay out such earnings to themselves as stockholders and then to acquire the bonds as individuals; thereafter, if they desired, turning in the bonds to the corporation in exchange for additional stock. In case these steps were taken, the corporation would pay no Federal taxes whatever as compared with present Federal taxes of \$680.52.

IV

Here is a railroad capitalized at \$300,000,000, of which \$150,000,000 is represented by first-mortgage $4\frac{1}{2}$ percent bonds; and the other \$150,000,000 by preferred and common stock. This railroad and its subsidiaries take advantage of the privilege under the present law of filing a consolidated return, which is subject to the corporation income tax rate of 15 $\frac{1}{2}$ percent. The consolidated net earnings of the railroad company, after depreciation charges but before interest, amount to only $3\frac{1}{3}$ percent on the total invested capital, or \$10,000,000. Interest charges absorb \$6,750,000, leaving \$3,250,000 available for the preferred and common stocks. Because the railroad does not expect to be permitted by public regulatory bodies to earn more than 7 percent on its total invested capital, it declares the value of its capital stock to be \$142,500,000 instead of \$150,000,000 or some higher figure.

- 4 -

Under the present law, the railroad corporation would pay the following taxes to the Federal Government:

Capital stock tax at \$1.40 per thousand	\$199,500.00
Excess profits taxes	0.00
Corporation income tax	<u>480,453.75</u>
Total	\$679,953.75

Under the proposed plan, this railroad would pay no Federal tax whatever if it paid out all of its earnings in dividends. Indeed, if it employed as much as \$1,000,000 of its earnings for retirement of debt, its aggregate Federal taxes under the proposed plan would amount to only \$512,500, as contrasted with \$679,953.75 that it would pay under the present law.

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V

Here is a progressive independent shoe store in a large city, retailing a complete line of shoes for the family through a number of branch stores. It operates a repair shop for the accommodation of its customers and has a fleet of pick-up trucks for delivery service. It is incorporated for and has declared its capital stock at \$150,000. Net earnings of \$16,281.29 before Federal taxes are reported, after deduction for all expenses of operation, including depreciation of machinery and delivery equipment.

Under the present law, this corporation would pay the following taxes to the Federal Government:

Capital stock tax at \$1.40 per thousand	\$ 210.00
Excess profits tax	64.28
Corporation income tax	<u>2,089.98</u>
Total	\$2,364.26

Under the proposed plan, this corporation would pay no taxes whatever if it paid out all of its earnings in dividends. If it decided to retain for purposes of increasing the number of stores or to add to its surplus an amount equal to 30 percent of its annual earnings, corporation taxes under the proposed plan would amount to \$2,163.29, a reduction of \$200.97.

Put this on my desk
April 6, 1936. *Please*

60

CLAIMS AGAINST THE CANADIAN DISTILLERS.

1. Although there were other smaller operators, five Canadian companies were responsible for the bulk of the liquor imported into the United States during the prohibition period, as follows:

Distillers Corporation-Seagrams.
Hiram Walker-Gooderham and Worts.
United Distillers.
Consolidated Distillers.
British Columbia Distillers.

The last named is the Reifel organization, and the Government's claim against this company has been compromised and settled.

2. The claims against the remaining four companies will be for customs duties and excise taxes on distilled spirits exported, directly or indirectly, by them into the United States during the prohibition period, as well as for the forfeiture value of such distilled spirits, and, in some cases, possibly for income taxes. The customs duty and the excise tax will be calculated at \$5 and \$1.10 per proof gallon, respectively. The forfeiture value of the liquor is taken as \$8 per proof gallon.

Extent of the Claims.

3. The total quantity of liquor exported to the United States by the companies named during the prohibition period was about 22 million proof gallons according to public records in Canada. The exact division of this quantity among the companies, however, is unknown. The Government's claims must necessarily be limited to quantities which it can

prove were imported into this country from Canada with the connivance of the companies. This can be established only as a matter of investigation, and it should be borne in mind that in the end the Government will be able to prove in court only a small fraction of the actual equitable liability of each company.

4. In the case of Distillers Corporation-Seagrams, the Department's investigations so far indicate a provable liability amounting to not less than 800,000 proof gallons, on which the taxes due would be approximately \$4,500,000 and the forfeiture value approximately \$6,000,000, or a total of something more than \$10,000,000. Any suit brought against this company would be for a sum substantially in excess of this total, but \$10,000,000 is indicated by Mr. Whitaker, Special Assistant to the Attorney General, who has been designated to handle the cases, as the minimum recovery which might be expected in the event of a judgment in favor of the Government.

5. In the case of Hiram Walker-Gooderham and Worts, the investigations thus far made by the Department indicate a provable liability amounting to approximately 1,000,000 proof gallons, on which the taxes due would amount to \$6,100,000 in addition to a forfeiture value of \$8,000,000, or a total of \$14,100,000. These figures represent only the estimates of the Department's investigators. They have not been passed upon by Mr. Whitaker.

6. The provable liability of United Distillers as established by the Department's investigations amounts to about 160,000 proof gallons, on which the taxes due would amount to approximately \$976,000 and the

forfeiture value to \$1,280,000, a total of \$2,256,000. The Department's evidence in this case has likewise not been passed upon by Mr. Whitaker.

7. The Department's investigations have so far not been extended to cover the operations of Consolidated Distillers. From information developed in the other cases, however, it is believed likely that substantial claims can be proven against this company.

Present Liquor Stocks of the Canadian Companies.

8. Since the extent of the Government's recovery will depend in large part upon the companies' available assets, particularly if the suits should be compromised before judgment, it is important to have in mind the quantities of liquor which they respectively own. The aggregate holdings by these companies of liquor of all types, including Scotches, gin, and other spirits not intended for the American market, is at the present time probably in the neighborhood of 35,000,000 American proof gallons. The holdings of American-type whiskey, such as rye and Bourbon, intended exclusively for the American market, is believed to be approximately 29,500,000 proof gallons, divided as follows:

<u>Name of Company</u>	<u>Quantity (in American proof gals.)</u>
Distillers Corporation-Seagrams.....	9,000,000
Hiram Walker-Gooderham and Worts.....	7,000,000
United Distillers.....	1,500,000
Consolidated Distillers.....	7,000,000
British Columbia Distillers.....	<u>4,000,000</u>
Total.....	<u>29,500,000</u>

The Bronfman Case.

9. The case against the Bronfman brothers (Distillers Corporation-Seagrams) is the only one now ready for suit in the Department of Justice. Mr. Whitaker has furnished the Department an extensive memorandum analyzing the available evidence in this case and indicating what he will be able to prove by such evidence. Following is a summary of his conclusions:

- (a) The evidence is sufficient to make out a criminal case against all the Bronfman brothers, although there will be great difficulty in securing a conviction before a jury, and the chances of such a conviction are not good.
- (b) There is sufficient evidence to make out a civil case against this company covering the illegal importation of approximately 800,000 proof gallons of liquor on which, as has been said, the company's total liability will be something in excess of \$10,000,000.
- (c) The civil suit will be in theory not a suit to recover directly the amount of customs duties and excise taxes due, but to recover damages, the measure of which is the amount of customs duties and excise duties out of which the Government was defrauded, plus the forfeiture value of the merchandise.
- (d) The principal difficulty in connection with the civil action will be to secure service of process on the defendant company inasmuch as that company is not now doing business in the United States.
- (e) Another important difficulty, of course, will be to secure payment of any judgment which may be obtained against this company in the event the Government is successful in obtaining such a judgment, this for the reason that it is doubtful whether the company has assets in the United States which may be reached in satisfaction of judgment.

Necessity for Pending Legislation.

10. As is evident from Mr. Whitaker's memorandum regarding the Seagram case, the Government's position with respect to litigation is not a strong one. This has nothing to do with the merits of the

Government's claims. It comes entirely from the fact that the companies are not now doing business in the United States and from the difficulties which will accordingly be encountered in securing jurisdiction over them in American courts and in obtaining payment of any judgments which may be rendered against them. It was to cure this weakness that the Department recommended the pending legislation to Congress. The effect of the legislation, if enacted, would be merely to compel the companies to submit to the jurisdiction of American courts in order that the claims against them might be litigated on their merits, and to give satisfactory security that judgments would be paid, under the penalty of being deprived of the privilege which they now enjoy of disposing of their liquor in the American market. The legislation, in other words, would greatly enhance the Government's chances for success in the prosecution of its claims and correspondingly increase the probability of satisfactory compromise settlements out of court.

HNG/mff

April 7, 1936.

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MEMORANDUM OF THE CONFERENCE HELD IN THE OFFICE OF THE
SECRETARY OF STATE AT 11 O'CLOCK, TUESDAY, APRIL 7, 1936.

Present:

For the State Department—
Secretary Hull
Under Secretary Phillips
Assistant Secretary Moore
Mr. Hickerson

For the Treasury Department—
Secretary Morgenthau
Assistant Secretary Taylor
Mr. Oliphant
Mr. Graves

Mr. Hull asked Mr. Morgenthau for a statement of his point of view with reference to the pending legislation. Mr. Morgenthau said that apparently the matter had come to an impasse between the two Departments; that he had read the copy of Secretary Hull's telegram to the President and the President's reply; and that as far as he was concerned his desire would be for the two Departments to get together and settle their differences themselves if it were at all possible. He felt that it was desirable to avoid burdening the President with this problem if it could be avoided. He said that, whatever our differences might be "in the family", it was essential that to outsiders we should present a united front. He suggested that Mr. Hull had best review the situation first, from the point of view of the State Department.

Mr. Hull stated that there were always many troublesome things progressing between this Government and Canada where it was extremely important that we have the good will, friendship, sympathy, and help of the Canadians. If there was any feeling of resentment on the part of the Canadians, it was bound to reflect itself in difficulties in negotiations on these other matters. Mr. Hull mentioned two such

matters specifically. One was the Great Lakes-St. Lawrence waterways project; and the other was the "dumping" of lumber in the Northwest. These were cited merely as illustrations of Mr. Hull's point, which was that we stand to lose a great deal if the Canadians are allowed to feel that they are being unjustly and arbitrarily dealt with about this particular thing.

Secretary Hull's view was that the State Department is bound to make representations to the Treasury Department with respect to the attitude of the Canadians, and that he is not so much concerned with the exact merits of the present proposition as with what the Canadians think about it. He felt that the Canadians in this case certainly feel that the legislation is unprecedented and unfair to them, and they are sure to be resentful if it is enacted. Therefore, the State Department desired, Mr. Hull said, to suggest to the Treasury Department that we take up and consider the course of action outlined in Mr. Wrong's note, and repeated in Mr. Hull's telegram to the President: That is to say, that we accept the Canadians' assurances that they will not accelerate their rate of exportation into the United States; that they will not export to other countries; that they will individually call upon the Treasury Department and undertake to arrive at a settlement of their respective claims; and that we agree to hold up the legislation for, say, one month to permit these steps to be undertaken, with the understanding that if they are not successful the legislation will be proceeded with. A condition of the plan would be that the Treasury will state the amount of its claim against each company.

Mr. Oliphant here stated that we have got to understand what we mean when we say "arrive at a settlement" of the claims. He said it would be one thing to try to arrive at a final determination of the amounts which the Canadians will pay to this Government, and quite another thing to determine simply whether the companies will give assurances that they will submit to the jurisdiction of United States courts and pay any judgments which may be obtained.

Mr. Hull felt that the Canadian proposition involved the former and not the latter point.

Mr. Oliphant pointed out that the whole strategy of the Canadian group was to bring about further delays. He called attention to the fact that the statute of limitations is running against the Canadian claims; that the cases are constantly growing staler; that the difficulty of holding witnesses is increasing. He said that the Canadians were thoroughly aware of these facts, and that this was undoubtedly responsible for the request of the Canadians to postpone consideration of the matter, possibly until the next session of Congress.

Mr. Morgenthau said he wanted to clear up the matter of the reservation to the Trade Agreement made at the time of signing, in order that he and Mr. Hull could have a complete understanding on that point. From a memorandum which Mr. Oliphant had given him, Secretary Morgenthau very carefully stated the various things which had happened, in chronological sequence, beginning with the visit of Mr. Hickerson to him on the afternoon of the 9th of November, 1935, and concluding with the signing of the Trade Agreement on November 15. When it came

to the matter of the release which the President gave to Under Secretary Phillips on the morning of Monday, the 11th, the facts were differently viewed by Mr. Oliphant and Mr. Hickerson. Mr. Oliphant had the impression that he had talked with Mr. Hickerson immediately before telling the Secretary that this matter was clear. Mr. Hickerson, on the other hand, said that Mr. Phillips received clearance from the President while he (Hickerson) was in Mr. Phillips' office, and that it was after that that he had the conversation over the telephone with Mr. Oliphant, in the course of which the Treasury reservation was read. At any rate, the opinion was generally expressed that this point did not make much difference. Mr. Hickerson made it plain that the Treasury Department had been told at that time that the proposed legislation would have no effect on the Trade Agreement, and that the question whether the reservation had or had not been adequately made prior to the time of signing was relatively a minor one.

Either Mr. Phillips or Mr. Hickerson stated, however, that at the time the President began his Armistice Day speech, which was at 11 o'clock Monday morning, and at the time Prime Minister McKenzie King was told the agreement had been cleared—at that time apparently the Canadians were unaware of the fact that the Treasury had asked that a reservation be made. It was stated by Mr. Hickerson that he read the reservation to the Canadian Under Secretary of State for External Affairs and to Mr. Hume Wrong, some time between November 11 and 15.

Judge Moore, after these matters had been canvassed, summarized the facts as he knew them from the beginning of his connection with this subject—which was at the time of the discussions with Mr. Whitaker

about the F. A. C. A. regulations to the same effect as the pending legislation (April 29, 1935)--up to and including ratification of the Trade Agreement by the Canadian Parliament. He conceded the accuracy of everything that had been said by Mr. Morgenthau. He said that this legislation could not be considered as having the slightest effect upon the Trade Agreement or as being in conflict with the Trade Agreement. He said we could well consider the proposed course of action being suggested by Secretary Hull, as stated in his telegram to the President, without any reference to the Trade Agreement, but with reference rather to the effect of the pending legislation upon the Canadians' sensibilities, and upon their probable future attitude toward the American people with respect to other matters which may come up affecting the two countries.

Mr. Phillips referred to the fact that the Canadians had in 1930 given up revenues of \$15,000,000 a year in order to aid the American Government in prohibition enforcement. He said the Canadians are a very sensitive people, like all other peoples who are geographically situated adjacent to a very powerful country like ours; and he said he felt that there was no escaping the fact that this legislation would be regarded by the Canadian people generally, rightly or wrongly, as unfair, discriminatory, and ungrateful, and that if the legislation were enacted without giving the Canadian companies a fair opportunity to make a voluntary settlement, this might adversely affect our future relations with Canada for a long time.

Secretary Morgenthau called attention to the fact that after all there was no genuine Canadian interest in this matter, since only a handful of people (he said three or four) were affected. He stated

that there were three groups of cases in the Treasury Department that worried him a good deal: the Louisiana income-tax group of cases; the Associated Gas and Electric cases; and this group of cases.

He said he had had suggestions made to him on behalf of the people in Louisiana that we come to some settlement. Those he had refused. Likewise, he had propositions made to him on behalf of Associated Gas and Electric. Those propositions he had also refused. And he had the same feeling with reference to this group of cases, that is, that there were grave objections to sitting down and compromising with important criminals. He said that in considering the course of action to be taken on this point it would be necessary to have the advice and approval of the Attorney General.

Secretary Morgenthau told the State Department that it was necessary to regard the Canadian distillers as gangsters and mobsters in fact. He said it is true that in the last few years they have become immensely wealthy, and have turned respectable, but a few years ago they were just the usual type of small-time gangsters or mobsters. They carried on with great unscrupulousness widespread operations in violation of American law during Prohibition. He said that the principals in these cases were on the level of bootleggers and smugglers, that they had been guilty of killings among other offenses, and that it was very repugnant to him to consider sitting down and talking with them about a settlement out of court.

In the end, he said that he would defer his answer to the proposition made by the Secretary of State, so that he could consider the matter further. An engagement was accordingly made for 11 o'clock, Thursday, April 9, at which time the subject will be further considered by the two Departments.

NARRATION OF THE STEPS TAKEN BY THE
TREASURY DEPARTMENT TO INSURE THAT
THE CANADIAN TRADE AGREEMENT WOULD
NOT INTERFERE WITH THE PROSECUTION OF
ANY LIQUOR CASES AND THE LEGISLATIVE
PROGRAM INCIDENTAL THERETO.

Revised 71
Apr. 7

Saturday, November 9, at 6:p.m., Mr. Hickerson of the State Department came in to see the Secretary of the Treasury. Mr. George C. Haas and Mr. Herman Oliphant were also present.

Mr. Hickerson had with him a draft of the proposed Trade Agreement with Canada and sought to induce the Secretary to advise the President that the Treasury Department would not object to the reductions in duty on those commodities in which the Treasury Department was primarily interested. Mr. Hickerson stated that both the President and the Secretary had already approved the reduction in the tariff on whiskey. The Secretary disclaimed any such approval by him prior to that time and reminded Mr. Hickerson that the Treasury Department had a potential fifty million dollars in claims against Canadian liquor distillers for uncollected taxes and duties and that his Department must require assurance that the proposed concession would have no effect on these claims. Mr. Hickerson said that the State Department had had these claims of the Treasury in mind and that his Department could not see that the Trade Agreement would affect in any way the Treasury's efforts to collect the taxes. At this point, Mr. Morgenthau talked to the President on the telephone and expressed his fear that the collection of the Government's claims might be affected by the Agreement and the President said, "Initial with the understanding that it is

subject to confirmation in forty-eight hours."

Mr. Morgenthau ended the meeting by promising to let the State Department have his opinion on the matter not later than Monday noon.

Sunday, November 10, the effect of the Trade Agreement on the litigation was given further consideration in the Treasury Department. As a result of the conference, a statement was prepared to express the understanding of the United States that after the consummation of the Trade Agreement the Canadian Government would cooperate with our Government's prosecution of the proposed litigation to the extent of making records and other information available to the United States as provided by existing treaty and that the objective of pending legislation affecting the right to import products of Canadian distillers involved in such litigation would not be considered inconsistent with the Agreement.

On Monday morning, November 11, at 9:20 Mr. Oliphant, Mr. Haas, Mr. Oppen and Mr. Frank gave further consideration to this statement, and at 9:25 A.M., Mr. Oliphant cleared it by telephone with Mr. Hickerson of the State Department, receiving assurances from Mr. Hickerson that the Department of State would act upon the statement in such manner that nothing further would need to be done by the Treasury Department to assure itself that its position was being safeguarded. Mr. Oliphant then had endorsed on one of the copies of the statement a notation of this telephone conversation with Mr. Hickerson.

At 9:30 A.M., the President telephoned the Secretary of the Treasury repeating Mr. Phillips' request to the President that the matter be cleared at once. The Secretary of the Treasury asked the President for two minutes. He then called Mr. Oliphant who told him that the matter had been cleared with the State Department. It was on the basis of this conversation with Mr. Oliphant that the Secretary of the Treasury cleared the matter of the Trade Agreement.

At 9:35 A.M., the Secretary of the Treasury considered the statement with

Mr. Oliphant, Mr. Haas, and others. He then transmitted this statement with a covering letter referring to the previous conversation of Mr. Oliphant with Mr. Hickerson to the Secretary of State. This letter was sent specially and received by the Secretary of State prior to 11 a. m.

On Thursday, November 14, at 5:45 p. m. Under Secretary Coolidge, Mr. Oppen, Mr. Turney and Mr. W. R. Johnson were discussing with Mr. Oliphant the final Treasury approval of the Canadian Trade Agreement, quite apart from the matter of the liquor cases. During this discussion, at 5:45 p. m., Mr. Oliphant again telephoned to Mr. Hickerson and requested information as to what steps had been taken to communicate to the appropriate representatives of the Canadian Government of the understanding of the United States set forth in the statement above mentioned. Mr. Hickerson replied that the statement had been shown to the proper representatives of the Canadian Government, who accepted it without question, and that nothing further was required to assure the United States that the consummation of the Trade Agreement would not interfere in any manner with the course of action on the part of the United States indicated in the statement.

The following statement is taken from a letter addressed by Assistant Secretary Moore to the Secretary of the Treasury under date of January 13, 1936:

" * * * As regards this fourth objection I may say that an officer of this Department, prior to the signature of the Trade Agreement, read to the Canadian Charge and to the Canadian Under Secretary of State for External Affairs the expression of the Treasury Department's views set forth on the enclosure to your letter of November 11, 1935."

PRESS CONFERENCE

Ambassador Sze, Mr. Chen and Secretary

April 7, 1936

HM, Jr.: I just thought you might like to know that Mr. Chen -- you all know the Ambassador -- is here from China on my invitation to exchange information on mutual monetary problems.

Q. You mean Mr. Chen is all the way from China specifically on this invitation or in connection with the opening of the branch office of the Bank of China?

HM, Jr.: I think Mr. Chen can answer that himself.

Mr. Chen: In New York I have my own business to look out for and also for the opening of the agency of the Bank of China.

HM, Jr.: He is going to be here for some time and we will have frequent meetings and I can't promise you a story every day. The chances are there won't be any, but if the Ambassador or Mr. Chen or I have anything that we want to say, either they or myself will give you the information or we will do it jointly.

Q. Anything today?

HM, Jr.: No; just getting acquainted.

Q. What do you look for as a result of these periodical conferences?

HM, Jr.: A closer working arrangement between China on their financial problems and the Treasury.

Q. Particular with regard to silver?

HM, Jr.: We will call it "financial problems."

Q. It would be silver, wouldn't it?

HM, Jr.: That enters into it.

Q. Could you outline some of the particular problems you are discussing?

HM, Jr.: Not today. We have just gotten acquainted and it will take a couple of meetings and, after all, our contact up to now

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with the Chinese Treasury has been entirely by cable and we have a lot of mutual problems, and I thought it would be distinctly to our advantage and I hope to theirs if we could have a face-to-face exchange of information.

Q. Couldn't you give us some hint as to the

HM, Jr.: Not today.

Q. I did not finish my question.

HM, Jr.: Bob (Thornburgh) is good today!

Q. I meant as to the -- you might say, objective?

HM, Jr.: No; just closer working arrangement; that's all.

Q. I wondered if perhaps Mr. Chen were interested in the very efficient manner in which our Stabilization Fund seems to work.

HM, Jr.: You can ask him that.

Mr. Chen: I have to learn that.

Q. That's what I thought!

Ambassador Sze: Do you think the Secretary will tell us?

Q. What was the size of the Equalization Fund created by the proclamations in China. How much was there in that fund?

Mr. Chen: We have no stabilization fund, but our whole currency is a managed currency basis.

Q. There was a specific fund set up, wasn't there, for the disposal of the Governors to control the foreign exchange value of the yuan? How much was in that fund?

Mr. Chen: We have not that fund. We call our reserve that fund.

Q. When you say that the object of this was a closer working arrangement with China, could you tell us where there is need to work more closely with China?

HM, Jr.: Well, if I tell you that, I would let Bob down and I

-3-

don't want to do that.

Mr. Thornburgh: I don't mind if you do that.

HM, Jr.: No; I don't want to do that. I think you are a little previous. But it is a good question!

Q. Is it a fact, in the managed currency of China with particular relation to the pound and the dollar, there is sometimes a lag as between London quotation and the New York quotation that sort of leaves the Chinese quotation at loose ends; that is, one figure in London and another figure in New York? And is there a need for some arrangement that will bring a closer tie between the London and the New York quotations simultaneously?

Ambassador Sze: At the present time, the Chinese currency is not linked to any foreign currency, but the Chinese Government Banks every day, every morning, quote what they will sell exchange on London, on New York, on Tokio, and so forth. Now, when it was first decided, we said that the Chinese dollar would be equal to 14½ pence and to America's dollar, 29.75 cents. That is about the time when the cross rate between London and New York was about \$4.80. Now recently she went up to over \$5.00. Then we have to vary the exchange on New York by half-cent leeway, one way or the other, so one time we went up to 30.30 and 30.35. Now it is coming back again to 30.12. So there is slight variation to guard against our people going to Chinese banks to sell dollar to Chinese banks and buy Sterling exchange, but the variation is now half-cent.

Q. Will the establishment of branch banks in London and in New York ease that situation? Help that situation some?

Ambassador Sze: The Bank of China has London office since 1929. But, of course, so far now the Chinese banks, the three Government banks, have agencies and also have relation with the Federal Reserve.

HM, Jr.: All right?

Q. Still a large question mark!

oOo-oOo

April 7, 1936

On March 31, HM, Jr. received the following telegram from Dr. Boyden who is President of the Deerfield Academy:

"At the suggestion of William C. Bullitt whose daughter has been at the Bement School in Deerfield for the past four years Mr. Bement and Mr. Keith would greatly appreciate an interview with you. They can come to Washington any time during the next week or so, soon as would be convenient for you. I know both the school and these men and am glad to join in Mr. Bullitt's endorsement. Hope you have had fine vacation with boys. Best wishes. Signed Frank L. Boyden."

Mr. Bement and Mr. and Mrs. Keith came in to see the Secretary today and related that the lower end of Deerfield, where the Bement School is located, is inundated by high waters and they wanted to know whether they could get some relief money and asked HM, Jr. to direct them to the proper office.

The Secretary called in McReynolds and asked him to take his three callers into his (McReynolds') office for further discussion and to contact Harry Hopkins' office for them to see if something could be done to help the Bement School.

Mr. Bement explained to the Secretary and to McReynolds that their difficulty in obtaining a loan was because they are a private school, "yet we are a home." He explained that he did not know whether the school was entitled to Federal aid, on a long term, but that was the purpose of his call. They left to go to Mr. McReynolds' office and McReynolds will help them to find out if the Government is in a position to grant the assistance they wish.

Tuesday
April 7, 1936

HMjr: Good morning
J.F.T.
O'Connor: Welcome back to our town.

HMjr: How are you?

O'C: Fine, thank you. Glad to hear your voice.

HMjr: Good - Jefty -

O'C: Yes

HMjr: It's just been brought to my attention that a bill has been introduced on the Hill -

O'C: Yes

HMjr: - taking - to make you the Conservator of Bankrupt Corporations under seventy-seven B -

O'C: Yes

HMjr: - and bankrupt individuals under seventy-four.

O'C: Yes

HMjr: Do you know anything about it?

O'C: Well, not a great deal about it. I haven't been up there except - Sabath was in here a couple of times -

HMjr: Yes

O'C: - discussing it last year when the - and across the street were very much interested in those tremendous fees that were being paid out in the reorganization of those big companies, -

HMjr: Yes

O'C: And they were trying to work out something that will stop the fraud in those reorganizations.

HMjr: Yes

O'C: And Sabath is the one who has been doing the most work about it. And he had - his original bill provided for the designation of one of three agencies - the RFC -

HMjr: Yes

O'C: - the Security Exchange or this Office.

HMjr: Well, of course, it's in Internal Revenue now.

O'C: No -- not this part of it. They have nothing to do with this - with this part of it -- not at all. No, they haven't got anything to do with this part of it at all. And so, up on the Hill there the Committee then in analyzing the thing found that there was only one -- there was only one place. Well, it was raised also - I must tell you this - it was raised also in the Senate Committee Hearing on the Bank Act of nineteen hundred and thirty-five. And the Senators over there raised the same question as to whether or not those reorganizations shouldn't be handled by this Office. Well, I said that was rather embarrassing and I'd rather not answer it. And they said, well, if it was embarrassing they didn't - wouldn't press me for an answer because I didn't know what position the Administration would take on it. So I got away from it in that way. And then they asked one of my boys up there two weeks ago. Well, he said we weren't looking for anything additional -

HMjr: Who was that?

O'C: Mr. Kit Williams

HMjr: Oh, yes

O'C: And we said we weren't looking for anything additional. Of course it was a matter entirely for Congress to decide and - as he thought, not for us. Well, then they asked him if we had such an organization that could do this. Well, he said he'd have to answer that in the affirmative because we'd handled these one thousand four hundred banks that involved a great deal more than the matters that they were talking about and we had more real estate. They asked about real estate reorganizations - we pointed out the fact that we had several thousands of those, of course, particularly in Detroit. And that was about the extent of that conversation.

HMjr: Yes

O'C: And frankly they haven't contacted me directly on the matter and I haven't taken any interest in it or made any statement about it.

HMjr: Well, before you do, will you have a talk with me?

O'C: Darn right I will - you bet I will!

HMjr: Because -

O'C: I think we ought to go over it pretty carefully and we ought to see just what information my boys have, Henry.

HMjr: Right

O'C: So we'll both do that?

HMjr: Yes

O'C: Thank you.

HMjr: Thank you.

April 8.

I sent word through Nicholson, today, that I wanted to see Chen alone on Thursday at my house at four o'clock.

April 8, 1936.

Filene came to see me about the Twentieth Century Fund. It seems that the Bureau of Internal Revenue have ruled that gifts to this fund are taxable. Filene claims that due to the wonderful work that they are doing, that we should give them a "friendly" ruling. I told him that we never give friendly rulings, but always give fair rulings.

He asked me whether he could not be referred to Oliphant and I asked for Oliphant, but he was out so I personally gave Filene's memorandum to Miss McGuire and asked her to have Oliphant prepare a memorandum on this matter for me.

April 8th

Mr. Morgenthau reported that he had walked down with Taylor this morning and told him to start selling the Baby Bonds through the banks by May 1st.

Before the 9:30 Staff Meeting this morning H.M.Jr. telephoned Key Pittman and told him that he was giving a dinner for K. P. Chen on Sunday and, of course, wanted him to come and also asked that he suggest who else he ought to invite from the Hill. Senator Pittman suggested McNary, Robinson, Fletcher and Pat Harrison. Senator Pittman told Mr. Morgenthau that he had an appointment for Sunday night but would try and cancel it. He is to let us know in the morning. H.M.Jr. told him that we have not gotten anywhere as yet with the Chinese, that we have just had a preliminary meeting yesterday but after we have gotten under way he would sit down with the Senator and tell him all about it.

Mr. Morgenthau also telephoned Mr. Phillips and the following is a record of their conversation:

H.M.Jr: Hull if he'd come - I don't know how he feels about those things, see?

P: I don't believe he would, Henry. In fact he never goes.

H.M.Jr: Well, you might mention it to him that I called up, anyway.

P: All right.

H.M.Jr: And then, I'd like to know who from the State Department would like to come - I mean, I'm asking you to let me know informally -

P: Yes

H.M.Jr: - who I should ask, you see?

P: Good

H.M.Jr: I'd like to ask anybody who you think would -

P: I think Hornbeck would be the proper person.

H.M.Jr: Yes - well, anybody else?

P: Well, I think Hornbeck and Hamilton -

H.M.Jr: I don't know Hamilton.

P: Hamilton is the number two there in the Far Eastern Division.

H.M.Jr: Well, wouldn't you come?

P: - Well, now, - I could let you know tonight.

H.M.Jr: Yes

P: As a matter of fact, I'm expecting my sister -

H.M.Jr: Yes

P: - Mrs. Bowling to spend the Sunday with me.

H.M.Jr: Yes.

P: And Caroline not being here -

H.M.Jr: Yes

P: I don't quite like to run away and leave her on Sunday evening. But I'll know definitely by tonight whether she is going to spend Sunday with me.

H.M.Jr: Well, would - supposing I'd call you back?

P: Yes, first rate.

H.M.Jr: I'll call you back in the -

I - I shan't see her until this evening.

H.M.Jr. Well, I - I'll call you in the morning.

All right.

H.M.Jr: And then, this meeting on the Canadian liquor which we had down for Thursday, I want to postpone that until Friday at eleven o'clock.

P: Friday at eleven?

H.M.Jr: Because we won't be ready.

P: Good.

H.M.Jr: See?

P: All right, I'll make note of that.

P: -- Yes

H.M.Jr: Well, why not let's say now, ten-thirty?

P: I think ten-thirty will be a little safer, don't you?

H.M.Jr: Well, why not let's say Friday at ten-thirty?

P: Friday at ten-thirty - good.

H.M.Jr: And that'll - - - that makes it all right.

P: That'll be all right.

H.M.Jr: Thank you.

P: And the Secretary asked me to thank you very much for your invitation to dine and to tell you that he never went out anywhere - he couldn't very well make an exception.

H.M.Jr: Well, I'm sorry.

P: All right.

H.M.Jr: And I'll talk to you again about that -

P: Yes, goodbye.

H.M.Jr: - tomorrow. Thank you.

At the 9:30 meeting McReynolds, Upham, Bell, Gibbons, Taylor, Oliphant and Gaston were present. Oliphant reported that Rene Leon had just returned from Mexico and asked to see him. Mr. Oliphant checked with Mr. Morgenthau as to whether or not he should see him. H.M.Jr. approved.

Mr. Morgenthau told Mr. Taylor to discuss with Mr. Oliphant the memorandum he was preparing on countervailing duties and that the two should have a meeting with Viner, who arrives in Washington tomorrow. A meeting with Mr. Morgenthau was set for Friday, 10 o'clock, on countervailing duties.

Mr. Gibbons did not have his memorandum on the Racing Commission but said he would have it by the first of the week.

H.M.Jr. asked Oliphant whether he heard anything lately on the Louisiana tax case and also whether Governor Moody was working for us. Oliphant said he did not know but would find out.

April 7, 1938.

Harry Hopkins and Corrington Gill came in to see the Secretary today. Mr. Bell and McReynolds were also present.

Mr. Hopkins stated that his organization was running short of funds on which to operate to such an extent as to make it necessary almost immediately to lay off large numbers of employees from projects under way, although large sums of money are still unexpended from allotments made to them. This comes about through the reservation being made of a sufficient amount to complete each project when it is started.

Mr. Hopkins proposed that Works Progress Administration be given its allotments by districts only and permitted to utilize the funds on any project in the district, and that no further limitation be placed upon them.

The Secretary stated that he was unwilling to concur in any change in present procedure without Mr. Bell having an opportunity to give the matter adequate study and submit his recommendation on it. The matter was left in Mr. Bell's hands with the understanding that nothing further would be done until he comes to the Secretary with his recommendation.

Hopkins then told the Secretary that he was going to testify tomorrow morning on the relief bill. He said, "The last word that I had on this word verbally from the President was that there would be \$1,500,000,000 for WPA and that everything else was out." Bell said that just before the President left on his fishing trip he wrote Bell a long-hand note which, in effect, said, Be sure and include in the bill Resettlement. Bell thinks he knows what the President meant by that, viz: to have in the bill the power to give Resettlement money, but no specific item entered in dollars; simply the power. The bill as it is now written does not include that power.

"I have to go on the Hill tomorrow," Harry Hopkins said. "The first thing that Buchanan is going to ask me is what does this Resettlement mean and how much money do you propose giving them? I think it is a devil of a fix to have me in because we are fighting against any kind of earmarking. They might throw the whole clause out. I just don't know what to say. I have not worried the President, because I did not want to bother him, but I do want

-2-

to do the right kind of a job. I do not want to say anything that will be unfair to Resettlement."

HM, Jr. then replied to Mr. Hopkins and advised him as follows: "The normal thing to say to you would be that I cannot advise you, but I will be rash enough to advise you. If I were in your shoes I would have asked the President what to do, but since you did not I would simply confine myself to the work which you are responsible for and would not attempt to discuss Resettlement. If Resettlement is to be discussed, I would suggest having the man come down who is responsible for it. Personally I have never testified up there with my tongue in my cheek. I would not attempt to testify and explain Resettlement."

Hopkins then said, "I cannot go up there and say that I do not know what the President has in mind." Bell interrupted and said he had said the same thing to Hopkins that HM, Jr. had, and that he agrees absolutely with Mr. Morgenthau's advice.

"What I am trying to get for my own information," he said to Mr. Hopkins, "are two things. I want, by months and by States, the number of people who are getting work from the Federal Government out of WPA, and then I want the number of people who are getting direct relief. Miss Lonigan gave me the attached. I am trying to find out, first, how many people each month are at work and how many people are getting direct relief with Federal money and on top of that, how many people are getting work or direct relief from non-Federal sources."

Turning to Mr. Gill, HM, Jr. said, "If you can't get it for the United States, can you give it to me for ten States; for instance, let's take Massachusetts, New York, Pennsylvania, Indiana and Illinois, and then you can select another five. I am taking States that I know are doing good work. All I want is to get the trend. It would be nice to get it for the whole country even if we can only get it from December 31."

Miss Lonigan came in at this point. He explained to her that he wanted two charts, one of which would show the trend for the country on work relief, and the other to show direct relief, broken down into the normal geographical sections. He told her that if the figures she has are for the number of people, then he wants the number of dollars expended so as to arrive at the average cost. Also, he

-3-

wants charts showing the cost per person for work relief and the cost per person for direct relief. Tabulated, the four sets of charts he wants are for the following:

1. Chart showing number of families, divided into work relief and direct relief.
2. Chart showing expenditures by number of families, divided into work relief and direct relief.
3. Chart showing expenditures, divided into Federal and State relief.
4. Chart showing the average cost.

MEMORANDUM

April 7, 1936.

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Mr. Hopkins proposed that Works Progress Administration be given its allotments by districts only and permitted to utilize the funds on any project in the district, and that no further limitation be placed upon them.

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McR:gmc

FEDERAL EMERGENCY RELIEF ADMINISTRATION - WORKS PROGRAMS ADMINISTRATION

Number of Families Receiving Aid - Direct Relief Only

In Thousands

1936

January February March April May June July August September October November December

New England

Maine
New Hampshire
Vermont
Massachusetts
Rhode Island
Connecticut

15 15
11 10
3 3
92 84
8 8
22 5

Middle Atlantic

New York City
New York - (Up State)
New Jersey
Pennsylvania

339 347
85 85
262 5

East North Central

Ohio
Indiana
Illinois
Michigan
Wisconsin

142 138
55 55
195 190
79 85
57 55

West North Central

Minnesota
Iowa
Missouri
North Dakota
South Dakota
Nebraska
Kansas

49 47
34 30
66 65
12 14
9 11
25 a 22 a
25 26

South Atlantic

Delaware
Maryland
District of Columbia
Virginia
West Virginia
North Carolina
South Carolina
Georgia
Florida

2 2
20 13
10 10
5 5
38 32
* a b
3 a 3 a
2 a 1 a
1 a 1 a

East South Central

Kentucky
Tennessee
Alabama
Mississippi

28 28
15 15
* a 7 a
14 b

West South Central

Arkansas
Louisiana
Oklahoma
Texas

3 a 8 a
5 a 5 a
* a b
37 a 37 a

Mountain

Montana
Idaho
Wyoming
Colorado
New Mexico
Arizona
Utah
Nevada

6 6
7 7
3 3
6 a 6 a
5 6
5 4
8 8
1 1

Pacific

Washington
Oregon
California

32 25
13 b
121 89

Continental United States 1,973 a (1,615) d

* Less than 500.

a Incomplete.

b No report received April 10, 1936.

c Figures are incomplete in about ten States.

d Figures are incomplete in four States that report regularly.

Revised as of April 11, 1936

Regraded Unclassified

FEDERAL HOUSING ADMINISTRATION
Number of Families Receiving AID - Direct Relief Only
In Thousands

	1935											
	January	February	March	April	May	June	July	August	September	October	November	December
New England												
Maine	13	13	14	15	13	12	17	17	16	13	13	13
New Hampshire	4	10	11	11	11	10	11	10	11	11	11	11
Vermont	5	5	5	5	4	4	5	6	5	4	4	4
Massachusetts	104	102	99	92	87	82	79	66	61	72	85	93
Rhode Island	14	14	14	13	11	10	10	9	10	11	13	8
Connecticut	33	34	33	31	29	26	27	26	26	25	24	21
Middle Atlantic												
New York City)												
New York - Up State)	444	434	437	429	415	402	398	411	409	372	345	329
New Jersey	167	169	164	163	154	148	145	141	139	134	128	110
Pennsylvania	369	380	463	464	458	435	430	470	499	481	411	295
East North Central												
Ohio	305	300	295	290	280	275	268	289	274	249	240	168
Indiana	93	94	92	85	79	70	61	93	68	70	60	56
Illinois	307	305	305	282	300	287	298	264	262	289	289	257
Michigan	172	160	149	134	130	127	128	136	144	141	135	104
Wisconsin	119	120	108	104	94	87	80	81	68	91	88	69
West North Central												
Minnesota	78	80	68	71	70	57	56	64	72	74	73	59
Iowa	53	50	50	46	42	33	29	25	27	29	35	34
Missouri	103	103	104	126	126	114	103	124	145	128	129	111
North Dakota	37	36	36	35	34	25	21	20	19	22	27	24
South Dakota	4	5	4	3	3	2	3	6	9	13	15	9
Nebraska	22	21	20	20	19	17	17	24	29	31	32	30
Kansas	27	24	22	21	22	19	18	22	61	63	59	35
South Atlantic												
Delaware	5	5	5	4	4	4	4	4	4	3	3	2
Maryland	46	46	46	45	38	33	31	31	33	34	33	28
District of Columbia	18	17	19	17	12	11	10	11	10	9	10	10
Virginia	22	18	12	11	10	9	15	14	10	10	22	13
West Virginia	42	40	37	34	39	36	44	78	77	75	70	56
North Carolina	49	46	49	50	44	39	39	38	36	36	40	14
South Carolina	43	40	38	30	31	34	13	7	6	7	10	7
Georgia	37	34	61	60	69	20	20	13	11	10	26	3
Florida	35	26	22	22	25	24	4	5	44	44	39	1
East South Central												
Kentucky	89	76	66	55	48	41	47	26	23	24	30	50
Tennessee	57	63	53	49	39	47	33	41	35	44	47	25
Alabama	39	35	33	33	28	28	32	39	32	44	30	17
Mississippi	33	32	23	24	23	20	20	20	20	23	29	29
West South Central												
Arkansas	69	69	61	53	52	50	55	34	22	21	18	*
Louisiana	22	20	24	25	35	19	20	19	20	23	29	9
Oklahoma	37	61	86	63	46	28	26	33	32	31	40	24
Texas	174	165	164	141	123	97	85	105	115	130	132	120
Mountain												
Montana	25	27	29	29	26	23	22	20	16	15	15	8
Idaho	13	24	25	23	21	17	12	15	10	10	15	7
Wyoming	7	7	7	7	9	4	4	3	2	2	1	2
Colorado	46	44	45	56	40	37	29	22	27	35	30	5
New Mexico	22	22	22	24	23	18	23	21	21	18	15	5
Arizona	14	10	16	10	8	7	7	18	17	14	11	5
Utah	23	22	23	24	22	20	16	20	16	21	20	11
Nevada	3	2	1	*	*	*	*	*	*	1	1	1
Pacific												
Washington	55	62	62	61	62	62	58	52	44	42	46	46
Oregon	29	26	25	26	23	22	19	16	14	16	19	12
California	190	189	121	134	134	144	151	185	201	198	198	175
Continental United States	3,679	3,635	3,711	3,597	3,391	3,135	3,063	3,286	3,340	3,288	3,253	2,563

*Less than 500.

FEDERAL EMERGENCY RELIEF ADMINISTRATION - WORKS PROGRAMS ADMINISTRATION

Number of Families of Workers Receiving Aid - All Programs

In Thousands

1936

January February March April May June July August September October November December

New England											
Maine	26	26									
New Hampshire	30	20									
Vermont	6	9									
Massachusetts	200	202									
Rhode Island	24	24									
Connecticut	51	28 b									
Middle Atlantic											
New York City											
New York - (b. State)	712	723									
New Jersey	181	181									
Pennsylvania	520	279 b									
West North Central											
Ohio	322	321									
Indiana	135	141									
Illinois	385	390									
Michigan	174	184									
Wisconsin	123	121									
West South Central											
Minnesota	113	112									
Iowa	67	69									
Missouri	152	157									
North Dakota	26	27									
South Dakota	26	27									
Nebraska	45	46 a									
Kansas	69	74									
South Atlantic											
Delaware	5	6									
Maryland	41	33									
District of Columbia	19	19									
Virginia	45	45									
West Virginia	93	88									
North Carolina	45 a	47 b									
South Carolina	39 a	39 a									
Georgia	55 a	54 a									
Florida	37 a	38 a									
West South Central											
Kentucky	91	97									
Tennessee	86	71									
Alabama	48 a	53 a									
Mississippi	50 a	40 b									
East South Central											
Arkansas	47 a	50 a									
Louisiana	64 a	62 a									
Oklahoma	93 a	91 b									
Texas	149 a	157 a									
Mountain											
Montana	22	25									
Idaho	20	21									
Wyoming	9	9									
Colorado	45 a	47 a									
New Mexico	18	19									
Arizona	18	19									
Utah	24	24									
Nevada	4	4									
Pacific											
Washington	72	70									
Oregon	22 a	22 b									
California	256	245									
Continental United States	4,924 a	4,694 d									

a. Incomplete figures for direct relief.

b. WPA only. No reports for direct relief.

c. Figures for direct relief are incomplete or not reported for about ten States.

d. Four States are missing in February that report regularly.

Revised as of April 11, 1936

FEDERAL EMERGENCY RELIEF ADMINISTRATION - WORKS PROGRAM ADMINISTRATION

Number of Families Receiving Aid - All Programs

In Thousands

	1935											
	January	February	March	April	May	June	July	August	September	October	November	December
East England												
Maine	22	22	21	24	23	22	24	24	22	19	27	25
New Hampshire	11	14	15	15	15	14	14	11	13	13	17	18
Vermont	9	11	9	10	9	8	8	7	9	7	8	9
Massachusetts	190	193	197	193	195	187	182	178	169	155	202	222
Rhode Island	20	20	20	20	19	19	19	18	20	20	22	26
Connecticut	49	48	47	46	44	42	40	39	40	41	34	32
Middle Atlantic												
New York City												
New York - Up State	572	581	583	573	558	541	533	547	525	510	783	744
New Jersey	178	180	179	174	165	157	144	150	155	156	226	203
Pennsylvania	474	493	504	500	501	473	465	477	461	550	609	587
West North Central												
Ohio	350	347	342	335	330	323	314	329	313	305	336	345
Indiana	137	137	134	129	124	115	108	122	119	127	150	136
Illinois	364	369	352	343	330	324	288	294	298	308	469	431
Michigan	222	206	197	186	175	169	165	164	173	174	227	195
Wisconsin	128	132	137	135	124	107	96	92	96	110	150	130
East North Central												
Minnesota	126	128	137	140	127	104	85	79	80	90	126	117
Iowa	70	70	69	69	60	50	41	34	35	35	56	65
Missouri	174	171	192	181	167	157	132	126	128	133	209	193
North Dakota	47	47	48	47	45	40	30	24	21	25	41	35
South Dakota	67	63	62	62	62	59	22	13	14	19	30	26
Nebraska	56	57	56	52	50	44	37	32	33	35	50	51
Kansas	90	91	90	88	88	80	63	63	64	67	98	78
South Atlantic												
Delaware	5	5	5	4	4	4	4	4	4	4	5	5
Maryland	51	54	53	50	46	38	35	35	34	37	49	47
District of Columbia	24	23	24	23	21	19	17	17	18	17	16	17
Virginia	51	52	53	57	58	52	50	49	49	47	62	53
West Virginia	100	97	94	93	93	89	88	87	85	83	117	108
North Carolina	78	75	73	62	77	71	61	55	51	53	79	53
South Carolina	74	68	65	60	62	60	39	41	30	34	49	51
Georgia	95	89	98	100	97	77	62	65	60	64	94	78
Florida	63	66	62	63	64	65	55	62	69	64	79	34
West South Central												
Kentucky	111	112	113	114	116	108	104	103	102	107	147	110
Tennessee	74	75	78	82	82	77	64	63	64	66	96	71
Alabama	24	23	23	24	22	24	24	24	24	22	72	65
Mississippi	21	23	24	24	23	23	24	24	24	27	59	63
East South Central												
Arkansas	69	90	84	80	75	74	58	63	51	45	57	43
Louisiana	73	64	73	74	67	64	55	56	55	57	85	60
Oklahoma	148	147	147	135	129	119	97	102	105	111	192	112
Texas	290	285	273	294	254	198	152	153	142	141	206	218
Mountain												
Montana	32	32	32	32	29	26	24	22	19	16	26	23
Idaho	29	26	27	27	29	21	17	17	15	19	23	18
Wyoming	10	10	11	10	10	7	6	5	5	5	5	6
Colorado	67	68	69	70	67	63	47	43	39	43	68	44
New Mexico	33	31	33	35	34	31	28	26	25	24	26	16
Arizona	25	23	24	24	23	20	19	14	17	14	14	17
Utah	33	34	34	34	31	27	25	25	24	24	32	26
Nevada	5	5	4	4	4	3	3	3	3	3	3	3
Pacific												
Washington	68	69	67	66	68	67	61	55	47	44	67	79
Oregon	42	42	41	38	34	30	26	24	18	19	34	32
California	275	273	269	266	264	240	231	223	205	213	306	302
Continental United States	5,469	5,432	5,464	5,352	5,165	4,799	4,372	4,422	4,375	4,449	5,991	5,360

Includes: Direct relief, emergency work program, and special rural and educational programs of FEPC. Also Works Program Administration.
 Includes: Resident single person families but not transients.

Revised as of April 11, 1936

April 8, 1938

Mr. K. P. Chen called on the Secretary today accompanied by Ambassador Sze to begin the series of conferences on China's monetary problems. Also present were Mr. Taylor, Mr. Lochhead and Mrs. Klotz.

The following is a report of the conversation between the Secretary and Mr. Chen.

HM, Jr.: Did you have a nice voyage?

Mr. Chen: Quite an enjoyable voyage. I wish to thank you for the courtesy you showed me all the way from Shanghai to Washington. You were so thoughtful in asking Mr. Nicholson to come with us.

HM, Jr.: I thought it would make it a little easier.

Mr. Chen: Dr. Kung asked me to hand you this letter and extend his warm personal greetings.

HM, Jr.: Just so that we can save you as much time as possible, these two gentlemen that you have brought with you -- do they want to discuss other matters than the monetary situation?

Mr. Chen: They are here to help me and Mr. Kuo is a student of economics. He has no other mission than to help me. He is generally a student of business conditions.

HM, Jr.: Who is the other one?

Mr. Chen: Mr. Koo is sub-manager of the Chung Foo Union Bank and Counselor of the Executive Yuan.

HM, Jr.: The question of Governmental loans will not be discussed?

Mr. Chen: No.

HM, Jr.: Mr. Sze, as I sent word to Kung, I thought it would be easier for Mr. Chen and myself if we did not take up, at this time, the Farm Credit Administration and Reconstruction Finance Corporation loans. There is no immediate payment due.

Ambassador Sze: There is a payment due June 1. I have received instructions from Kung that I should take them up.

HM, Jr.: Mr. Chen's visit has nothing to do with these loans. I suppose you know that during the past week all the loans have been taken over by the Export-Import Bank. From now on you will only have to talk to Mr. Pierson of the Export-Import Bank and not to Jesse Jones and Dr. Myers. For your information, Mr. Taylor is representing the Treasury on the Export-Import Bank and if you at any time want to discuss the loans with us, please take it up with Mr. Taylor.

I do not know whether you want to get down to business?

Mr. Chen: I am ready at any time. I do not always carry figures in my mind, but I will check them up and let you know.

HM, Jr.: Talking for the United States Government, the only interest that we have in these financial discussions is to help China. In this discussion we are not interested in any concessions. As far as the Treasury is concerned, it is purely monetary. We feel we can be instrumental in helping you and in the long run we will be helping ourselves. We feel it is very important to the world peace to help China strengthen her currency, because the way I see it, that is the center of the whole thing as far as China goes. If you have a strong currency, your problems will solve themselves more readily. That pertains to any Government. In discussing this thing, we have no axes to grind. We do not want anything.

The reason that I asked that your Government send someone is that we might learn a little bit more about what your plans were. I appreciate you have been through a terrible situation. Your panic came two years after ours. We had ours in 1929-30.

Mr. Chen: And ours came at the end of 1934.

HM, Jr.: You are just beginning to come out of it. With this tremendous change in the price of silver, we would like to know if you can tell us just which way you are leaning; what your gold is; what is your ultimate aim. Those are the sort of things, if you can tell us, we need if we are going to be helpful.

Mr. Chen: Our present rule is to maintain the present

system of currency and since we changed the system, business has been much better and we never enjoyed such a stable foreign currency and the people are satisfied. And when we started to change, we were a little bit afraid that it might not work. We were afraid of the mentality of the people.

Since November 4, our conditions speak for themselves. Business is picking up. There are less bankruptcies. Export has been much better. I asked one business man before I left and he said this new currency is a good currency. People can't keep paper money underground. Therefore, it is the aim to keep the present managed currency. The flight of capital is coming back.

HM, Jr.: Where did it mostly go?

Mr. Chen: London, New York. This money is gradually coming back.

HM, Jr.: The normal remittances of Chinese people that they make home -- are those beginning to pick up?

Mr. Chen: It is good. Not normal yet.

HM, Jr.: Talking about Southern China -- they have not yet adopted your new money?

Mr. Chen: No. Before I left, they sent a representative to see Kung, but it is a very complicated problem.

HM, Jr.: I understand that you are going to have a meeting in May with the southern provinces. That must have happened since you left.

Mr. Chen: That I do not know anything about.

HM, Jr.: How is the north of Shanghai?

Mr. Chen: It is quite good.

HM, Jr.: How many banks issue paper money?

Mr. Chen: Four.

HM, Jr.: That is something we would like to talk to you about as we go along. We are wondering if it is to the best

interest of China to have four different groups issuing paper money.

Mr. Chen: We want to reorganize our Central Bank of China so as to make a bankers' bank. Just now, the Central Bank of China is all Government capital and we will sell 40% of the shares of the bank and only Chinese bank can buy.

HM, Jr.: The so-called Farmers' Bank -- we can't quite understand. They seem to be able to issue any amount of paper money and what we wonder is what they have got to back it up with. We are told that that bank is owned by the General and that there seems to be no limit to the amount of paper money that seems to come out of the Farmers Bank.

Mr. Chen: The origin of that bank is sponsored by the General. They can issue up to \$100,000,000. The purpose of keeping that organization is that we were afraid of trouble with Japan, and we wanted a bank in the interior.

HM, Jr.: What I would like to have is a description, first, of the Central Bank of China. What its capital is? How much currency it has outstanding and what the metallic reserves, if there are any? Then there are three other banks. What their powers are to issue money and what their monetary reserves are? Mr. Lochhead said that we have some figures and they could bring them up to date.

Mr. Chen: I have figures up to March 1.

HM, Jr.: If we can have the correct picture up to date of the Central Bank and the three other banks; in other words, I want a complete financial picture of these banks.

Mr. Chen: I can give you some rough figures now. There are \$700,000,000 capital; silver, \$315,000,000 Chinese dollars; foreign currency, \$112,000,000 Chinese dollars; \$25,000,000 worth of gold, and altogether we have 75% reserve against notes issued and 25% in Government bonds. I will furnish you with a memorandum.

HM, Jr.: For a starting point, that is just what I want.

Mr. Chen: In addition to that, we are liquidating other banks which formerly enjoyed the privilege of issuing notes. For the last three months we have been busy liquidating these

banks. We are not quite finished yet and are still doing it.

HM, Jr.: How about Government bonds outstanding?

Mr. Chen: I will give you another memorandum on this.

Mr. Taylor: Haven't these bonds all been consolidated?

Mr. Chen: Yes.

Mr. Lockheed: Can you furnish us with figures as to currency outstanding by banks other than the four we have discussed?

Mr. Chen: Yes, I think I can furnish you with a memorandum.

HM, Jr.: I would say, for the first meeting that I have asked for quite a lot of information and I do not expect it all tomorrow, but as you get it, bring it in and we will have some more questions as we go along.

What I would like to do, Mr. Ambassador, is to give Mr. Chen an official dinner at my house Sunday night.

Ambassador Sze: Sunday night is all right for us.

HM, Jr.: Could you give me a list of those whom you would like to invite? This is a stag dinner. I will ask some of the senators who are interested in the Chinese problem.

While you are here, Mr. Chen, any information that you want about our Government, I will put our people to work to get that information for you. Bring me a list of the questions that you want to have answered.

The press will ask me about Mr. Chen's visit. Don't you think we ought to tell them that we are discussing monetary matters?

(It was agreed to talk to the press, and HM, Jr. called in Mr. Gaston.

HM, Jr.: Mr. Gaston, we are discussing what we should tell the press.

Mr. Gaston: I told them not to expect much today.

HM, Jr.: I will abide by what you say, Mr. Ambassador. After all, they know that Mr. Chen has come over here for a purpose. He certainly did not come all the way from China just to talk to me about the weather or to see the cherry blossoms! If you want to make a vague statement, it is O.K. with me. I told Gaston to tell the newspapers that I have asked Mr. Chen to see me and he is here on my invitation to discuss monetary matters of mutual interest to the two Governments.

Ambassador Sze: I do not like the word "discuss."

Mr. Gaston: I suggest "exchange of information." (The Ambassador liked that much better.)

HM, Jr.: Which way would make it easier -- for Mr. Chen to have the newspaper men come in here or would you rather that they held him up as he goes out?

Mr. Chen: I would rather have the men come in here so you can help me answer the questions that they might put to me.

(The newspaper men came in at this point.)

MINISTRY OF FINANCE

Shanghai
March 11, 1936

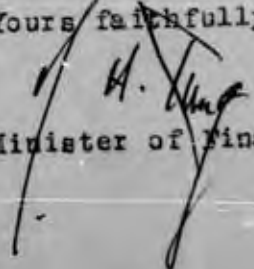
The Honorable Henry Morgenthau
Secretary of the Treasury
Washington, D.C.
U. S. A.

Dear Mr. Secretary:

This letter will be handed to you by Mr. K. F. Chen, whom I am sending as my personal representative to discuss with you currency problems of common interest to the Chinese and American Governments. I am asking Mr. Chen to place himself at your disposition to supply you with full information concerning the financial situation in China, and to explain the monetary policy and program of the Chinese Government.

At the commencement of these conversations I wish to assure you of the earnest desire of the Chinese Government to cooperate closely with the American Government in currency matters. It is my sincere hope that these conversations may lead to an understanding on the basis of which both countries may pursue their respective monetary policies in full accord.

Yours faithfully,


Minister of Finance.

With the Compliments of
SAO-KE ALFRED SZE.



CLASSIFICATION OF RESERVES AGAINST LEGAL TENDER NOTES ISSUED.

	November 2 1935		December 31 1935		January 25 1936		February 29 1936	
	Amount (in \$1,000)	%	Amount (in \$1,000)	%	Amount (in \$1,000)	%	Amount (in \$1,000)	%
Legal Notes outstanding	\$415,372	100.0	\$641,555	100.0	\$719,569	100.0	\$700,046	100.0
Cash Reserve:								
Silver	\$234,899	56.6	\$253,283	39.5	\$276,143	38.4	\$315,469	45.1
Foreign								
Currency	---	---	\$106,456	16.6	\$140,255	19.5	\$112,267	16.0
Gold	\$ 17,125	4.1	\$ 19,047	3.0	\$ 17,229	2.4	\$ 35,987	5.1
Other Cash								
Items	\$ 28,551	6.9	\$ 54,032	8.4	\$ 69,888	9.7	\$ 41,422	5.9
Total Cash								
Reserve	\$280,575	67.6	\$432,818	67.5	\$503,515	70.0	\$505,145	72.1
Security								
Reserve	\$134,797	32.4	\$208,737	32.5	\$216,054	30.0	\$194,901	27.9

COPY

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CLASSIFICATION OF RESERVES AGAINST LEGAL TENDER NOTES ISSUED.

	November 2 1935		December 31 1935		January 25 1936		February 29 1936	
	Amount (in \$1,000)	%	Amount (in \$1,000)	%	Amount (in \$1,000)	%	Amount (in \$1,000)	%
Total Notes out- standing	\$415,372	100.0	\$641,555	100.0	\$719,569	100.0	\$700,046	100.0
Cash Reserve:								
Silver	\$234,899	56.6	\$253,283	39.5	\$276,143	38.4	\$315,469	45.1
Foreign Currency	---	---	\$106,456	16.6	\$140,255	19.5	\$112,267	16.0
Gold	\$ 17,125	4.1	\$ 19,047	3.0	\$ 17,229	2.4	\$ 35,987	5.1
Other Cash Items	\$ 28,551	6.9	\$ 54,032	8.4	\$ 69,888	9.7	\$ 41,422	5.9
Total Cash Reserve	\$280,575	67.6	\$432,818	67.5	\$503,515	70.0	\$505,145	72.1
Security Reserve	\$134,797	32.4	\$208,737	32.5	\$216,054	30.0	\$194,901	27.9

TREASURY DEPARTMENT

101

INTER OFFICE COMMUNICATION

DATE April 8, 1936.

TO Secretary Morgenthau

FROM Mr. Haas *HA*

Subject: Condition and status of loans to the Government of China made by the Grain Stabilization Corporation in 1931, and by the Reconstruction Finance Corporation in 1933.

Loan by Grain Stabilization Corporation, 1931:

A loan was made to the National Government of the Republic of China by the Grain Stabilization Corporation in accordance with the "American Wheat Loan Agreement", September 25, 1931.

Purpose of the loan was to finance the sale by the Grain Stabilization Corporation of 15 million bushels of wheat to the Republic of China.

The loan was assigned to the Farm Credit Administration on June 19, 1933, and to the Export-Import Bank on April 6, 1936.

Security for the loan: The loan was secured by the Chinese Customs Surtax.

Principal - \$9,212,826.56. Payment of principal was required in three annual installments of \$3,070,942.18 each on December 31, 1934, December 31, 1935, December 31, 1936.

Interest - 4% per annum, payable on December 31 and June 30.

Payments made - Principal and interest payments have been made in accordance with requirements.

Payments due - Sums remaining to be paid: \$3,070,942.20 of the principal is due December 31, 1936, and interest payments are due June 30, 1936, and December 31, 1936.

Loan by Reconstruction Finance Corporation, 1933:

In May 1933 a credit was granted the National Government of the Republic of China by the Reconstruction Finance Corporation.

The purpose of the loan was to finance the sale of American wheat and cotton to China.

Secretary Morgenthau - 4/8/36, 2.

The credit established was for \$50,000,000, 80 per cent of which was to be expended by China for American cotton, and the remaining 20 per cent for wheat and flour to be purchased in the United States.

In March 1934 the original amount of \$50,000,000 was reduced to \$20,000,000, of which \$10,000,000 was to be used for cotton, \$6,000,000 for wheat, and \$4,000,000 for flour.

Security for the loan: First charge on "Consolidated Taxes consisting of the rolled tobacco tax, the flour tax, the cotton and yarn tax, the match tax, the cement tax, the tobacco and wine tax, the stamp tax". These taxes were represented as producing 22 million U. S. dollars in 1932. Additional security consisted of a second charge on China's 5% Flood Relief Customs Surtax, subject only to payments required to service and retire the indebtedness due the Grain Stabilization Corporation.

Principal of loan: The cotton and wheat credits were used up, but the flour credit was not all taken up by the expiration of the date specified. The total of the loans was \$17,105,385.80.

Terms: Advances were evidenced by notes of China payable on or before three years from the date thereof, with the understanding that China would probably request an extension for an additional two years on any balance then remaining unpaid. All notes carried interest at the rate of five per cent per annum payable semi-annually.

Payments made: All payments have been met as due.

Payments due: There remains due \$13,537,387.79 on account of principal; and \$187,348.96 accrued interest.

This information was obtained from a letter from the Export-Import Bank to Mr. Taylor, dated March 31, 1936; from press releases of the Reconstruction Finance Corporation; and from telephone conversations with Mr. Pierson of the Export-Import Bank, and Mr. Slaven of the Reconstruction Finance Corporation.

April 9, 1936

Dr. Viner attended the 9:30 group meeting this morning, having been invited by the Secretary to come to Washington in connection with the countervailing duties situation. Also present were Mr. McReynolds, Mr. Upham, Mr. Haas, Mr. Taylor, Mr. Gaston and Mr. Oliphant.

HM, Jr. turned over to Dr. Viner a letter from Secretary Hull and told him that Oliphant and Taylor both had material for him and that he was free to call on anyone for assistance. HM, Jr. explained that in connection with the German countervailing duties he, personally, did not want to become involved and had never touched it, but that now it looks as though he would have to, one way or the other. P20

Taylor reported that he had been doing some "scouting" about the mysterious Dr. Victor H. Clark, of the Library of Congress, who is about to become Economic Adviser to the Philippine President. Dr. Viner said he knew him very well and would ask him what his connections are to be. HM, Jr.'s understanding was that the War Department had asked for recommendations, but Mr. Taylor said no; they had a list which they sent out to the Philippine Government and then said, We don't know what will come of this, but it isn't closed if you want to recommend someone else. Then we discovered, he said, that Dr. Clark was going. HM, Jr. did not attach a great deal of importance to it.

McReynolds reported that Senator Wagner's housing group have been calling for assistance, on detail matters, from the people who worked from the Treasury standpoint. Peter Grimm had called him, he said, and asked him if he would let Mr. Wilmerding respond to calls from Wagner and the housing group when they wanted assistance as to what had happened, and McReynolds had said he would not do this without HM, Jr.'s personal approval. Wilmerding is still with the Treasury, doing some special research for McReynolds which is entirely apart from anything he did on housing.

HM, Jr. said his instinct was definitely not to permit Wilmerding, as long as he is with the Treasury, to work with Wagner and his group. His thought was the Treasury has to fight on the appropriation end of Wagner's bill and we can't consistently do that and at the same time have a Treasury man a part and parcel of Wagner's staff. McReynolds very definitely felt the same way. HM, Jr. said if Wilmerding does anything on the Housing work he will have to disconnect himself

-2-

from the Treasury.

Oliphant stated he had had a telephone call from Hall Roosevelt saying he wanted to talk to him about some foolish things Oliphant's subordinates were doing in connection with taxes and the memorandum he, Mr. Roosevelt, had submitted to Oliphant. Oliphant said he was going up on the Hill and suggested that Gaston or Upham talk to Mr. Roosevelt. HM, Jr. said to Oliphant, "I would just forget about it today and if he calls you up again, turn him over to me."

TREASURY DEPARTMENT

105

INTER OFFICE COMMUNICATION

DATE April 9, 1936

TO The Secretary
FROM Mr. Taylor

Correspondence from Secretary of State
and report of Executive Committee on
Commercial Policy re Countervailing Duties

It is reasonable to assume that Congress imposes duties for revenue purposes and in order to create or maintain competitive positions for American industries, and that the duties thus imposed shall apply equally and fairly to the products of all nations. In other words, I do not believe that it was or is the intention of Congress to give a competitive advantage to a particular form of government or to a particular monetary or price system. Just as it is desirable to place all forms of business enterprise in this country on the same basis of taxation, so is it desirable to place the products of all countries on the same footing as regards assessment and payment of duties.

This Administration is strongly committed to a liberal most-favored national trade policy, which will remove restrictive trade barriers as rapidly as possible, and it is hopeful that the example which this country is setting will not only be helpful in expanding profitable international trade, but also in the furtherance of our good neighbor policy and international peace. It is my belief that as long as this policy prevails that all Departments and agencies should conform to it in every way possible, in other words, it is an Administration policy.

It is common knowledge that currency depreciation by certain countries in 1930 and 1931 materially altered the competitive position of American industries and that of countries which remained on the gold standard competing for a place in this market. In effect, a country which depreciated its currency gained a competitive advantage in this market, both in "value" for customs purposes and in the amount of duty actually paid.

Our own devaluation tended to restore the competitive position of our industries vis a vis the countries whose currencies had depreciated but likewise somewhat arbitrarily increased the handicap already carried by the countries which formed the "gold bloc" or which for various reasons chose to cling to a nominal "gold standard." For

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illustration I attach a memorandum prepared by the Division of Research which portrays this situation.

Exchange control, licensing of imports and exports, rationing of exchange, purchase and sale of exchange at varying rates, or purchase and sale of goods and services at varying prices in order to produce foreign exchange in the interests of the national economy, are merely phenomena which attend the abandonment of the gold standard, or any other free functioning monetary standard.

When the monetary standard in question has been abandoned, all the criteria which applied before cease to exist. Either the economy of the country becomes "controlled," or depreciation is allowed to run its course. Either action involves a transition period during which equilibrium is sought, one by conscious control, the other by a form of "laissez-faire."

When a "control" method is adopted, the government in effect creates a governmental monopoly of foreign trade in all its aspects. Whether this control or monopoly is complete as in the case of the U.S.S.R. or merely strongly controlled as in the case of certain Latin American countries, the principles of control and monopoly remain. The practical evolution of the control naturally assumes different aspects in each country and is governed by political expediency, the recent experience of the particular country, etc. A country which has suffered a recent experience in laissez-faire or stimulated extreme currency depreciation is politically unable to repeat this performance and is forced to choose control or currency manipulation, or a combination of various artificial methods which tend to conceal from its people the true state of affairs.

I am impressed by the report of the Executive Committee on Commercial policy and the statements contained in the letter from the Secretary of State and I believe that the points raised in this report, as well as the correspondence with the Federal Reserve Bank of New York on the subject of certifying multiple rates, introduce factors which demand a complete review of the situation.

It is my understanding that most Supreme Court decisions dealing with customs cases and in particular with countervailing duty cases were handed down in periods of comparative currency stability or involved a simple bounty payment. I feel that there is at least a reasonable doubt that the multiple currency procedures against which it is proposed to impose countervailing duties fall within the bounty or grant provisions of section 303.

I do not feel that I can approve the proposed Treasury Decision or that I can recommend to you that you approve it.

Wayne Taylor

Enclosure

TREASURY DEPARTMENT

108

INTER OFFICE COMMUNICATION

DATE April 9, 1936.

TO Mr. Taylor

FROM Mr. Haas

Subject: An illustration of a hypothetical exchange rate-price situation.

1. The quoted (official) rates of exchange on the mark, yen, and belga in July 1930, 1932, and 1935, were as follows:

Exchange rates in New York

	1930	1932	1935
	Cents : Index	Cents : Index	Cents : Index
Mark	23.87 : 100	23.72 : 99.4	40.35 : 169.0
Yen	49.35 : 100	27.45 : 55.6	29.15 : 59.1
Belga	13.97 : 100	13.87 : 99.3	16.91 : 121.0

2. If cotton gloves were sold at the equivalent of 30 marks (c.i.f.) per gross in all three countries in July, 1930, the dollar price of German, Japanese, and Belgian gloves landed in New York, plus an import duty of 60% ad valorem, would have been:

<u>Origin of gloves</u>	<u>In foreign currency</u>	<u>In U.S. dollars</u>	<u>60% Ad valorem</u>	<u>Price in U.S. Including duty</u>
Germany	30 marks	\$ 7.161	\$ 4.30	\$ 11.46
Japan	14.5 yen	7.16	4.30	11.46
Belgium	51.3 belgas	7.16	4.30	11.46

3. In July, 1932, under the assumption that the prices in terms of local currencies had remained the same, the c.i.f. dollar prices in the U. S. would have been:

<u>Origin of gloves</u>	<u>In foreign currency</u>	<u>In U.S. dollars</u>	<u>60% Ad valorem</u>	<u>Price in U.S. Including duty</u>
Germany	30 marks	\$ 7.12	\$ 4.27	\$ 11.39
Japan	14.5 yen	3.98	2.39	6.37
Belgium	51.3 belgas	7.12	4.27	11.39

4. In July 1935, again under the assumption that the prices in terms

of local currencies had remained the same, the dollar c.i.f. prices would have been:

<u>Origin of gloves</u>	<u>In foreign currency</u>	<u>In U.S. dollars</u>	<u>60% Ad valorem</u>	<u>Price in U. S. Including duty</u>
Germany	30 marks	\$12.11	\$ 7.27	\$19.38
Japan	14.5 yen	4.25	2.54	6.77
Belgium	51.3 belgas	8.67	5.20	13.87

Using a 24-cent rate for mark exchange in computing the cost, exclusive of the import duty, and the 40-cent rate for the dollar value basis upon which the 60% duty is imposed, the following dollar price of gloves from Germany is obtained:

Germany	30 marks	\$ 7.20	\$ 7.27	\$14.47
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5. Computation of changes in the exchange rate-wholesale price ratios from July 1930 to July 1932, and July 1935, for Germany, Japan, and Belgium:

Index of Exchange Rates in New York

	1930		1932		1935	
	Cents	Index	Cents	Index	Cents	Index
Germany	23.87	100	23.72	99.4	40.35	169.0
Germany	23.87	100	23.72	99.4	24.	100.5
Japan	49.35	100	27.45	55.6	29.15	59.1
Belgium	13.97	100	13.97	99.3	16.91	121.0

Index of Wholesale Prices

	1930	1932	1935
United States	100	76.4	94.1
Germany	100	76.8	81.4
Japan	100	83.6	101.8
Belgium	100	69.3	74.3

Ratio of U. S. Prices to Foreign Prices

	1930	1932	1935
Germany	100	99.5	115.6
Japan	100	91.4	92.4
Belgium	100	110.2	125.8

Mr. Taylor - 4/9/36, 3.

Change in Exchange-rate-wholesale price ratios

Index plus 100 represents a favorable change from the base year (1930)
 Index less than 100 represents an unfavorable change from the base year (1930)

	<u>1930</u>	<u>1932</u>	<u>1935</u>
Germany	100	100.1	68.4
Germany (24-cent rate)	-	-	115.0
Japan	100	164.4	156.3
Belgium	100	111.0	104.0

6. Changes in the prices of cotton gloves produced in the United States and of those imported from Germany, Japan, and Belgium, computed under the assumption that the price in local currencies of the cotton gloves changed exactly as did the index of wholesale prices of cotton print cloth in the United States, of cotton shirtings in Japan, of cotton cretonne fabric in Germany, and of finished goods (move closely with textiles) in Belgium:

Index of wholesale prices of:

	<u>Cotton shirtings in Japan</u>	<u>Cotton cretonne fabric in Germany</u>	<u>Print cloth in U.S.</u>	<u>Finished products in Belgium</u>
July, 1930	100	100	100	100
July, 1932	89	56	55	71
July, 1935	135	75	119	72

Under the above assumption of price movements in terms of local currencies, the dollar prices in the United States of cotton gloves produced in the United States, Germany, Japan, and Belgium would have been as follows:

	<u>1930</u>	<u>1932</u>	<u>1935</u>
United States	11.46	5.16	13.64
Germany	11.46	6.37	14.53
Germany (24¢ rate)	-	-	10.85
Japan	11.46	5.66	9.14
Belgium	11.46	8.08	9.98

April 9, 1936

14:00 pm

Present: Ambassador Sze; Mr. K. P. Chen, Secretary Morgenthau, Assistant Secretary Taylor and Mr. Lochhead.

Mr. Sze: You asked for a list for the dinner. I have two names, but if it is too much, too many, you can cut it down to one.

HM, Jr.: No; that's fine.

Mr. Chen: I brought with me another letter from Dr. Kung with memoranda on the financial position of the Chinese Government and the currency situation of China.

HM, Jr.: That's fine.

Mr. Chen: And he asked me to present it to you.

HM, Jr.: Fine! I will read this out loud. This is dated the 13th. It came very quickly.

Mr. Sze: Mr. Chen brought it with him.

HM, Jr.: Do we have mail service -- are they using the plane service to Hawaii?

Mr. Sze: I tried it on one occasion, but it was very unfortunate because that was the time the Clipper went out and result -- it got to Shanghai later than by air mail to Seattle.

HM, Jr.: Then it goes by Canadian Pacific?

Mr. Sze: By Canadian Pacific or by the American Line.

HM, Jr.: Do all steamers stop in Japan?

Mr. Sze: They all do. There are steamers -- some steamers do not stop which start at San Pedro or Portland.

HM, Jr.: (Preparing to read Dr. Kung's letter,) Well, I am not going to read that right now. That looks like a lot of valuable information and I certainly appreciate it.

Mr. Chen: Certain information -- questions on which we

touched yesterday more or less, more fully are covered in the memorandum on the monetary policy and including latest figures of the reserves and notes issued and I shall be glad to supplement any information.

HM, Jr.: I want to study this. We all do.

Mr. Sze: I hope you enjoy it more than I did! I read it yesterday.

HM, Jr.: Unfortunately, most of my reading has to be of this kind. I don't get much chance to read cultural reading.

Mr. Chen: Yesterday you asked me a question on the legal tender separated in North China and South China. Now I want to just supplement that.

HM, Jr.: Excuse me, Mr. Chen. Mr. Lochhead, have you a small map of China so I can follow the small provinces of China. When you get to speaking of the provinces, Mr. Chen, I don't follow as well as I should.

(Mr. Lochhead produced a map of China.)

HM, Jr.: Which of the provinces are using the money of the Central Government?

(Mr. Chen proceeded to mark the map.)

Mr. Chen: Four provinces are not yet using legal tender.

HM, Jr.: Which ones are? How would you mark those?

Mr. Lochhead suggested drawing circles around those that are using it.

HM, Jr.: I saw that your Government protested on Outer Mongolia. The Russians are just taking it for granted that was theirs.

Mr. Sze: They have been flirting with it for a long time.

Mr. Chen: Chinghai, they use it, but not very much. It's too far away.

HM, Jr.: That brings up the question, Mr. Chen -- we may as well start on that. We are naturally interested in a

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greater use of silver. We have expressed ourselves on that before and we have heard a lot of rumors about the half-dollar yuan and the 50-cent piece.

You asked our Mint in Philadelphia to make dies for you. Then we understood that you are going to take the blanks and were going to get -- this is the way we hear it -- with certain alloy in it, made in London and the coins minted in London. If that was so, then the amount of the purchase of silver in London would affect the silver market frightfully -- a lot. If you started to buy silver in London, you would really be buying Hong Kong silver to have your coins minted there. As I understand it, is the Mint in Philadelphia going ahead with the making of these dies?

Mr. Lochhead: They are still going ahead with the making of the dies. The last word was they had a cable from the mint at Shanghai asking them to expedite the work; also asking for dies to be made over in London.

HM, Jr. I wonder if that could be cleared up. What your policy is going to be about the use of silver in the yuan and the half-yuan.

Mr. Chen: I am glad you brought up this question. Before I left Shanghai I had a long talk on this subject. We have not decided our policy, as to the contents, amounts of silver to be used for the token money, and we have not made any policy at all and this will wait until I go back. Some suggestion was made to adopt the British method of 500-fine coins and this is a question that we will be very much interested in because we do not know the future of silver. We don't know the price of it. If we are putting in too much we will have another bad smuggling.

HM, Jr.: Well, we might as well get down to this subject.

Mr. Chen: And if we put too less in we cannot protect against counterfeiting and counterfeiting in China is something very difficult to protect.

Mr. Lochhead: I understand they are counterfeiting your new subsidiary coins already.

Mr. Chen: I have brought a sample for you, Mr. Secretary, of Chinese coins. No half ones yet. No silver yet. You

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will find in the memorandum it gives the weight and the mixture, alloy, and the amount of our legal tender.

HM, Jr.: Thank you very much.

This question of what you do with your yuans and half-yuans is important to us, and after all, right now, we have been able to stabilize the price of silver through practically buying the newly-mined production of North and South America. That's about what we are doing. We have an arrangement with Mexico where from month to month, every month it can be renewed or they can reject or we can reject, whereby we agree to take their newly-mined silver at a daily price. I don't know whether you are familiar -- are you familiar with our arrangements with Mexico and Canada?

Mr. Chen: I have read it in the newspapers.

HM, Jr.: I will sketch it. They can cancel or we can cancel each month. Incidentally, Mr. Taylor, I don't think the dates of maturity with Mexico and Canada are the same, are they?

Mr. Lochhead: They are both in the middle of the month. We renew in the middle of the month, but it's for the calendar month.

HM, Jr.: The middle of the month we take it up with their central bank and we give them the price we post each day. It has worked out very well for about three months. It just looks as though the newly-mined production that we are taking off the market each day, each week, plus the tremendous demand for silver from India -- tremendous demand from India for silver from India -- plus the fact that the English are handling their Hong Kong silver; they feed it just as the market will take it and they are shipping a lot of silver from London to India and the Indian stocks are down to about 6,000,000 ounces. We just had a cable yesterday and the demand continues there. Whether Hong Kong has shipped 100,000,000 ounces all out of Hong Kong -- Lochhead, is it all pretty well out now?

Mr. Lochhead: Not all.

HM, Jr.: How much do you figure?

Mr. Lochhead: They have shipped, between India and London,

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about 75,000,000 ounces; there are about 25,000,000 left.

HM, Jr.: They offered us 100,000,000 ounces and we said we would not take it. They have about 25,000,000 ounces left and I guess they are having their troubles with their currency. As a matter of fact, their currency is not as steady as yours and there is some talk of their going back on silver.

Mr. Chen: Foreign exchange banks are all anxious to see China go back to silver because there is a profit there. When I passed through Japan I spoke to the President of the Yokohama Specie Bank and had conversation on this Chinese currency question. Suddenly he said, "I have to cut my personnel." I asked Why? He said, "There is no money there." So judging from that, I can understand.

HM, Jr.: Their interest and ours is entirely different.

Mr. Chen: Very different.

HM, Jr.: I haven't figures yet on how much silver your Government controls. Is that included in the memorandum.

Mr. Chen: Yes.

HM, Jr.: How much is it?

Mr. Chen: \$365,000,000, Chinese. But the increase, the people are bringing their silver to the different banks quite steadily because all currency has been monetized; it cannot be passed in the market as legal tender so in the springtime and the autumn, when we have tax collections from the land, so we expect a great deal of this to come out. When it comes out it will be under control of the Government banks.

HM, Jr.: You expect more?

Mr. Chen: Gradually; steadily.

HM, Jr.: I am very frank, as the Ambassador knows. This amount of silver that China has is naturally the biggest amount of silver and we don't know which way it is going to move. When you say to me you don't know how much silver to put into your coins because you don't know what the future price of silver is going to be, so the two things are related; that is one of the things we want to talk about. Naturally we would like to

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see you, all things being equal, figure your silver on fineness and so forth the United States way, because the more of the countries which figure their silver at \$1.29 and 999 fine the nearer it becomes being some uniform way of figuring the silver. The question of the future price of silver, what we are going to do about silver, depends very much on what happens here on your trip.

Mr. Chen: We anticipate that.

HM, Jr.: And the thing I want to give today is the thing -- if it is good for China, the thing we would like to see you do is to do just what we are doing here for your yuan and half-yuan silver so that a part of this large supply of silver you have would go into the use of money. Now your people are used to a hard money. We have had this same thing up with Mexico. They changed, when silver went to around 71 or 72 cents, they were faced with the problem that at that time it was profitable to demonetize their silver. Now they have put their peso on \$1.29.

Mr. Lochhead: And subsidiary coins at \$1.38. I think it is \$1.38 to agree with our subsidiary coins.

HM, Jr.: Will you get a memorandum for Mr. Chen?

Mr. Lochhead: Yes, I will.

HM, Jr.: Let's do it this way. I would like to have it myself. How much silver there is in our half dollar and how much in the silver dollar; what the Mexicans have done and what the Canadians have done. How do the Canadians figure it? Who else now is? Any of the South American countries?

Mr. Lochhead: Not to any great extent.

HM, Jr.: It gets down to ours, Mexico and Canada.

Mr. Lochhead: Great Britain uses 500 fine. It's token kind.

HM, Jr.: In Great Britain? How about India?

Mr. Lochhead: That works out at about \$1.05 an ounce. It is a varying figure.

HM, Jr.: Have Miss O'Reilly fix up a little memorandum and

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she can do that this morning and send one to the Ambassador and one to Mr. Chen, but, as I say, as I see the picture today, here is this large quantity of silver in China. You don't know what to do with it. Undoubtedly it must be a big source of worry to you. One question, as I see it, is the question of subsidiary coins. The next question, that would use up I don't know how much silver, but I would be interested to find out, if you begin to coin the subsidiary coins, how much silver would that use?

Mr. Chen: We also propose to use some, to coin some one-dollars as token money because we found it is rather expensive to use notes -- paper -- because when you handle it too much

HM, Jr.: It is very expensive. We figure here that a paper dollar can only be used seven times and then it has to be destroyed.

Mr. Chen: The standard of the Chinese people -- the requirements for one-dollar coin is much more in circulation.

HM, Jr.: What's why our silver-dollar is used by people who -- it's the workman's dollar. That's one question. What you are going to do with your yuan and half-yuan? How you are going to figure it? And I don't know whether in this thing -- I want to read it, because there may be a lot of important answers -- how much monetary metallic reserves you expect to set up against your paper money? I suppose that is in here, isn't it?

Mr. Chen: It's there some; not fully. The question is to use how much silver in connection with our bank notes. According to law, the Chinese reserve is 40% Government bonds, 80% in silver. But we found now, silver we cannot make it, because we want to have foreign exchange in order to defend, protect ourselves from attack, and as time goes on, just now the volume of currency is still very small in proportion to our business. If we can establish confidence in this legal tender, if we can stand the attacks that we will be faced with afterwards, we feel volume of bank notes will be expanded, much expanded, very much; easily reach the amount of 1,000,000,000 which is more or less pretty near that figure now, but later on with the success of this new monetary policy we expect to increase to at least 200,000,000,000 or 250,000,000,000 dollars very easily, but in that case we will probably, after confidence in the currency is established,

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more silver will come in.

HM, Jr.: As I say, the question of your metallic reserves -- what you are going to do with this silver, what we can do to help you, whether you may want to exchange some silver for gold or silver for exchange -- the whole thing ties in together.

Mr. Chen: The present percentage of silver is 45%.

HM, Jr.: Against what?

Mr. Chen: Against the whole note issue. 16% of foreign currency, 5% in gold and other items 5.9, altogether our present reserve is 72%. I said a little while ago, if our bank notes expand, increase, the amount of notes are increased, naturally the silver will also increase. This increase will come from the interior because business is better.

HM, Jr.: Do I understand, or has that not been settled, your present silver reserve is 45%.

Mr. Chen: 45%.

HM, Jr.: And under the law you have to get it up to 40%?

Mr. Chen: Under the law, 60% when we are on the silver standard.

HM, Jr.: But now, how much?

Mr. Chen: Now we like to figure foreign currency, should have 35%.

HM, Jr.: And how much in silver?

Mr. Chen: There will be 25%. We are just figuring it.

HM, Jr.: Just tentative?

Mr. Chen: Just talked it. We would like to see that. Because we have that fear of attack.

HM, Jr.: And how much gold would you think?

Mr. Chen: Maybe half or little less than half. 30%. 35%.

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HM, Jr.: No; in foreign currency. Silver, 25% and 35% in foreign currency and part of that in gold. That's 60% and the other 40% would be Government bonds?

Mr. Lochhead: Those figures, are they included in the other memorandum?

Mr. Chen: That's up to the end of February, but I give comparative figures from November, before we change to new currency, and month of December and month of January and month of February.

Mr. Lochhead: Could we have a copy of that memorandum?

Mr. Chen: I can let you have a copy.

Mr. Lochhead: Fine!

HM, Jr.: In the silver stocks you have 380,000,000 yuan. Those are the old yuan coins that you brought in, so when you are figuring them you are figuring those as actual silver yuan?

Mr. Chen: Yes. Maybe small portion in bars; in Shanghai mint, bars.

HM, Jr.: You have been melting down any of those?

Mr. Chen: Not much lately. Before.

HM, Jr.: For general purposes we can figure those yuan are figured for ounces, same as purchased coins?

Mr. Chen: Yes.

HM, Jr.: Are foreign business men beginning to accept your currency?

Mr. Chen: All except Japanese banks.

HM, Jr.: How about the United States?

Mr. Chen: Standard Oil Company.

HM, Jr.: They are? Good!

Mr. Chen: General Electric.

HM, Jr.: Very good!

Mr. Chen: British American Tobacco Company.

HM, Jr.: Yes.

Mr. Chen: They have been very nice.

HM, Jr.: And the Chase and National City?

Mr. Chen: Oh, yes! They are working with us very nice.

HM, Jr.: Any trouble?

Mr. Chen: No trouble.

HM, Jr.: So the only troubles are the Japanese.

Mr. Chen: The Japanese.

HM, Jr.: Do the Japanese Nationals in Shanghai -- they won't use your money?

Mr. Chen: Oh, yes!

HM, Jr.: But not the banks?

Mr. Chen: Except they won't give us their silver. Otherwise...

HM, Jr.: They won't give up their silver? Do they have much?

Mr. Chen: About 10,000,000 ounces.

HM, Jr.: And that, most likely, cost them a lot of money.

Mr. Chen: It did.

HM, Jr.: On those two raids the Japanese made on you, you must have made money on that.

Mr. Chen: Yes.

HM, Jr.: Because they tried to sell your exchange down.

Mr. Chen: Yes. One Japanese banker told me they would sell their own holdings of silver to the Japanese Government

HM, Jr.: Very good!

Mr. Chen: British American Tobacco Company.

HM, Jr.: Yes.

Mr. Chen: They have been very nice.

HM, Jr.: And the Chase and National City?

Mr. Chen: Oh, yes! They are working with us very nice.

HM, Jr.: Any trouble?

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Mr. Chen: Yes.

HM, Jr.: Because they tried to sell your exchange down.

Mr. Chen: Yes. One Japanese banker told me they would sell their own holdings of silver to the Japanese Government

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instead of to the Chinese Government. Just what they say!

Mr. Lochhead: Not much profit in it for them to sell now.

Mr. Chen: No.

HM, Jr.: Is there any movement, to speak of, of silver in or out of China today?

Mr. Chen: No, not much. Before there was big smuggling when the price was very high, but you have stopped that and we very much appreciate it.

HM, Jr.: It was most important that -- we don't want to go over past history, but, after all, Congress passes a law and I am directed and ordered to do so and so and I had to do what I was ordered to do, or resign. And it took time, until these people who were interested in the price of silver were convinced that what we were doing was not to the best interests of the United States Government and once they became convinced of that we were able to let the price of silver go down and the thing happened so quickly, and as far as I know now, the so-called "Silver Senators" are entirely satisfied. They never bother me. And, as I say, they saw China recover rapidly. They have been more than pleased. There is no pressure on me to do anything about silver, one way or the other. We don't buy any silver in London any more at all.

Mr. Chen: You don't buy from the open market?

HM, Jr.: No. We are only buying newly-mined silver. That's right, isn't it?

Mr. Lochhead: We buy some silver in New York, probably not all newly-mined. We don't have a strict regulation that it must be newly-mined. I would say 95% is newly-mined.

HM, Jr.: But there is no silver moving in here from London.

Mr. Lochhead: Very little. At various times the market drops in London. People who use silver commercially will buy it in London market rather than here.

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HM, Jr.: But the silver which is bought in London comes into commercial use?

Mr. Lochhead: Into commercial use. We have seen a couple of small cases, but too small to bother making any fuss about.

Ambassador Sze: How do you test whether this silver is newly-mined?

Mr. Lochhead: On every bit of silver we get affidavit of sale.

Mr. Chen: This percentage I just gave you is only in connection of our legal tender reserves. We have not counted bank deposits. And that is very important item. If there is attack on Chinese currency and rush for foreign exchange, the deposits in bank should also be protected. If you take those figures in, you will find our reserve is not so good. Drop something like 12% or 15% in term of foreign currency.

Mr. Lochhead: A question between your currency outstanding and bank deposits.

HM, Jr.: Who besides Japan would want to attack your currency?

Mr. Chen: Japan today is much better. When we started she feared that this was bound to be a failure, consequently made all kinds of remarks in Shanghai. They have powerful intelligence agents in China and they publish Japanese newspapers in every city. They enjoy the privilege of freedom of speech and the Chinese newspapers and the English newspapers observe the proper courtesy so their publication circulation is good.

HM, Jr.: But that's not read by the Chinese?

Mr. Chen: Yes; also printed in Chinese. Also, people who have studied in Japan and studied the Japanese language. So with that propaganda it did work sort of harm to us, but now it is much better.

HM, Jr.: How about England?

Mr. Chen: England? Sir Frederick Leith-Ross is still

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in Shanghai. He has been already helpful with moral support. When we decided to change the currency, Sir Frederick Leith-Ross managed to get a Government Order in Council and have it fixed up very quickly, the 4th or 5th of May. That order instructed all the British subjects in China to accept legal tender and except that his moral support ...

HM, Jr.: Nothing else?

Mr. Chen: Nothing else.

HM, Jr.: Is the gossip true that he is having his troubles with the Hong Kong-Shanghai Corporation?

Mr. Chen: They don't agree.

HM, Jr.: The Hong Kong and Mr. Leith-Ross don't agree?

Mr. Chen: That's right.

HM, Jr.: What does he want them to do? Go on a managed currency?

Mr. Chen: Yes.

HM, Jr.: And they don't want it?

Mr. Chen: They don't want it. They fear Chinese currency is too high. It's not good for Chinese trade and, therefore, not good for trade between China and England and must come down. Our currency has been over-valued and Hong Kong Bank says you must stick to

HM, Jr. They say the same thing about the dollar. They say the dollar is over-valued. But evidently where you have your currency fixed in relation to ours, it's advantageous to Chinese because it shows where your trade has increased.

Mr. Chen: We followed this example of managed currency. We found it very happy today.

HM, Jr.: It seems to be.

Mr. Chen: Not "seems", but we are already happy. And today the business man finds new hope.

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HM, Jr.: My record is good and I was the first ...

Mr. Chen: You have to put the United States stamp on that, making that announcement. That had tremendous effect on the people in China. That statement which you have made in the cable, release in the press, and upon that news I can see the smile of the people, the business people and the Government people. We feel confident. We liked the encouragement.

HM, Jr.: You needed it!

Mr. Chen: Ever since we talked about reform in currency we had rather inferior complex for fear people would think we are not right -- nothing to do -- you are not able to do -- you don't have strong Government. And now it is all over.

Ambassador Sze: They advised you must have big loan to carry this through. Figure always 10,000,000 pounds. So when China went over, everybody said, possible, you could not do it. When you bought 50,000,000 ounces, they thought this thing can go on. People began to feel there is going to be some backing, some backing of the system.

HM, Jr.: And the move you made to take on some gold and the suggestion I made to put it in the Federal Reserve Bank and get recognized as a Central Bank, I think that all helped.

Mr. Chen: Very much!

HM, Jr.: Are the Germans very active in China?

Mr. Chen: Quite.

HM, Jr.: In what way?

Mr. Chen: In giving credit; not in money, for goods, railways.

HM, Jr.: You mean steel rails, locomotives?

Mr. Chen: And rolling stocks.

HM, Jr.: How long credits do they give?

Mr. Chen: Five to ten years. If you wish, if you are

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interested, I can give very confidential memorandum of that.

HM, Jr.: I would like to have that.

Mr. Chen: And the British operator, Boxer Indemnity, which also gives credits for business.

HM, Jr.: And what are the French doing?

Mr. Chen: Nothing. French are very careful.

HM, Jr.: But the Germans are giving long-term credit?

Mr. Chen: You know why. She wants foreign currency. She must find outlet for her goods in order to get credit in London and New York, because her currency is blocked. Sometimes merchandise sold -- goods in Germany -- can't get money.

HM, Jr.: We either. We had a big shipping concern come in and they had all this money tied up over there and we said, You had better go to the State Department.

Mr. Chen: We have in China, just now, economic delegation. Kiep delegation.

HM, Jr.: A very important one.

Mr. Chen: I don't know what is real intention, but he is staying there and meeting our people and talking over things. I know he is there for something.

HM, Jr.: But you don't know for what?

Mr. Chen: I know that something is going on. They have two big firms in Shanghai.

HM, Jr.: That's the big electric company.

Mr. Chen: They have just completed agreement for sale of some goods. There is another one by name Otto Wolf. He has already in his business the railway between Kansu (?) and Manchow (?) that is financed partially by the German goods on long-term credit. And we have same thing on the Boxer Indemnity arrangements. If you wish ..

HM, Jr.: Yes, I would.

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Mr. Chen: Just for your record.

HM, Jr.: The information I get does not get back to China or anywhere else.

Mr. Chen: Washington. It is not my business to talk these things, so if you are interested ...

HM, Jr.: I am very much interested. I am so terribly ignorant on your problems and in order to be helpful anything that bears on your manufacturing or your commerce or your industry helps me and it's --- our own representatives give us so very little information. At least I don't get it. I don't think it comes out. So if you know, from my standpoint we are not interested in competing with Germany to sell you locomotives; I am not interested in selling you this or that, but I am interested and if I can see the kind of help that you are getting, it all helps to influence me as to how it all affects the monetary and the foreign exchange situation. What about Russia?

Mr. Chen: Russia, very quiet.

HM, Jr.: Have they anything to sell or do they buy?

Mr. Chen: I think they will withdraw from the Chinese market. They can't stand competition of Standard Oil Company and the Asia Petroleum (Shell) and the Texas. They can't stand that.

HM, Jr.: Why?

Mr. Chen: Before I left Shanghai, Chinese company had plant installation for the selling, marketing of oil; has been sold to Standard Oil Company and Shell.

HM, Jr.: Together?

Mr. Chen: Together they bought it. That shows that Russian oil has lost a connection in China.

HM, Jr.: And this Chinese company was distributing Russian oil?

Mr. Chen: Yes. Haskin, the director of Standard Oil

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at Shanghai -- his words are "Prejudiced." They can't profit because of bad management, but from Russian source -- I saw Russian Ambassador. I asked him. He said, standard of living in Russia has been going up and we need all the oil for home consumption. This is diplomatic talk. I don't know how much truth in that!

Mr. Taylor: They have been having trouble with their production and their production has been declining in their good fields and I think possibly that's a contributing factor.

HM, Jr.: No question, they are opening up all sorts of luxuries. No question, they are letting the standard of living go up.

Mr. Chen: Russia wanted credit from China to buy Chinese tea and there is not so much credit in China to give away so we did not pay much attention to it.

HM, Jr.: Did they buy the tea?

Mr. Chen: Yes; not very much.

HM, Jr.: That's what they do. They try to get long-term credit and when they can't, they pay gold.

Mr. Chen: The Chinese banks and Chinese business men, we don't care for long-term credit. We want circulation and pay to some other people.

HM, Jr.: Let me ask you a question a little bit different along the Russian thing. Looking towards the success of your Government, are these war attacks as between the Russians and the Japanese on the frontier, is that a good or bad thing looking over, say, five years or ten years -- these clashed as between the Russians and the Japanese. What influence does it have on China -- not today, or tomorrow, but say five to ten years?

Mr. Chen: That is very difficult to answer, because I do not know enough about diplomatic situation. Some of the business men feared that Russia and Japan may not be able to fight yet. That's just street talk. Not much value there. They fear that Russia may not care to fight just now. Japanese situation is northern situation in our country territory.

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HM, Jr.: Let me ask you this, if this is a fair question. Are the Japanese -- have they slowed up any in their drive towards the South or are they pushing?

Mr. Chen: When I left China I received a very long letter from my manager in Tientsin. According to that letter, it is slowing up. And if they don't make any further attack on our currency and they seem anxious to come to some sort of understanding with China -- that was before I left China, in spite of this trouble in Tokio. But when I passed Tokio I met our Ambassador there and he seems not so cheerful.

HM, Jr.: The publicity I thought, today, was very good about the meeting yesterday. Entirely satisfactory.

Ambassador Sze: Yes.

Mr. Chen: I have not seen it. I have been looking for it.

Ambassador Sze: I read it in the Wall Street Journal. I was teasing him about being here "sometime."

Mr. Chen: I will be here as long as you want me. I don't want to hurry.

HM, Jr.: This memorandum, I have to read it. With our Congress in session we have a great many things and it's -- I have been away for a month. I have been sick and I can't work the way I used to. I feel much better today. I have been out of my office a full month, so what I want to do now -- I would like to take this and digest it; read it carefully. And let me just see when we can get together. I have tied myself up on these mornings. What is today? Wednesday? We have Cabinet on Friday. The President gets back Friday. I have that darn Canadian liquor thing. That takes more time! Do you want to go to New York?

Mr. Chen: I don't have any particular work to do there, but I can go anytime. I am not anxious to go.

Mr. Lochhead: Mr. Chen remarked to me outside that there is no time limit on his stay here.

HM, Jr.: I would like to meet again Friday and I am in

a sort of a jam here. I don't like to be hurried on these things, that's the point. Do you mind if I could call the Ambassador sometime this afternoon, because I am sort of mixed up. I am all right tomorrow, but the trouble is I won't get a chance to read this and I want to read it very carefully.

Mr. Chen: Please, you don't have to make a fixed engagement today. I am at your service any time. I have nothing to do, except sightseeing. This is the only work I have. Anything that will suit you -- I know how busy you are.

HM, Jr.: I am just trying to figure. I have to read this, but if I could call the Ambassador and give you a ring. In the meantime, everything is quiet. Of course, we are very much interested in this French election which comes off in about two weeks, but we don't think anything will happen with the French franc.

Mr. Chen: Very bad situation.

HM, Jr.: But what will happen right after that, I don't know. But I don't think anything will happen in the next two weeks.

Mr. Lochhead: No.

Mr. Taylor: Do you think those boys will be ready with your Canadian liquor thing tomorrow?

HM, Jr.: Is there anything I can do while you are here to have you go around. A car?

Mr. Chen: You have done all you can.

HM, Jr.: Mr. Sze, are you taking him around? Would you like to see the Bureau of Engraving and Printing?

Mr. Chen: I saw it 28 years ago.

HM, Jr.: Or perhaps you would like to run up to the Philadelphia mint?

Mr. Chen: I am here to meet you and to prepare myself.

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HM, Jr.: You have given me what I call "homework". I want to read this.

CHINA



SHANGHAI OFFICE
MINISTRY OF FINANCE
15 THE BUND

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Strictly confidential

March 9, 1936.

Enclosure

Memorandum

The financial position of the Chinese Government

1. In connection with the monetary reform adopted November 3, 1935, the Government adopted a program of balancing the budget in 18 months. Such a program was deemed essential in order to avoid jeopardizing the currency through inflation resulting from continued borrowing, especially from the banks. In carrying out that program, however, the Government has been meeting with serious difficulties because of falling revenues, particularly customs, and the impossibility under existing conditions of materially reducing expenditure.

2. The following statement compares net total revenues and payments during the past five years (figures in millions of dollars), as reported by the Accounts Department of the Ministry of Finance:

Year ending June 30	Net total pay- ments (exclud- ing cash bal- ances at end of year) (1)	Net total rev- enue (excluding net proceeds from borrowing) (1)	Deficit	Percentage of deficit to payments (1)
1931	774	557	217	28.0
32	749	619	130	17.4
33	699	613	86	12.2
34	836	689	147	17.6
35	941	745	196	20.8

(1) The figures shown in this table differ from those given in published reports of the Ministry of Finance, in that the Department of Accounts has now adopted the practice heretofore followed by the Directorate General of Budget, Accounts and Statistics in showing costs of revenue collection under payments

3. The financial results of the fiscal year 1934-35 are shown in detail in Annex I. The following is a summary:

(Millions of dollars)

Revenue:

Customs	353
Salt	167
Consolidated taxes	105
Tobacco and wine taxes	11
Government enterprise receipts (largely from railways)	61
Other	48
Total	745

Payments:

Party and civil expenses	237
Military expenses (including \$58,000,000 representing cost of military payments for previous years)	388
Government subscription of bank capital (net)	74
Loan service (including foreign loans and indemnities, \$93,000,000; domestic loans (net) \$139,000,000; and debt readjustment fund \$5,000,000)	237
Net additions to reserve and suspense items	5
Total	941

4. Calculation of deficit.

Gross payments	\$940,928,456.11
Revenues	744,922,042.20
Gross deficit	196,006,413.91
Adjustment for capital items	73,500,000.00
Net operating deficit	\$122,506,413.91

to the Ministry of Finance instead of as a deduction from revenue. Hence the figures for 1931-34 have been revised on this basis.

5. The above-mentioned "Adjustment for capital items, \$73,500,000" is the net amount of additional funds provided by the Government for subscription of bank capital in order to meet the emergency conditions which existed during a large part of the last fiscal year.

6. During the current fiscal year 1935-36 the deficit has been at a higher rate than in 1934-35, and according to preliminary figures was about \$146,000,000 for the six months ended December 31, 1935. The increased deficit resulted from various causes.

7. There has been a material decrease of customs revenue in the last eight or nine months. This is due to various conditions: the disturbed international situation which discourages import commitments; wholesale smuggling by Japanese and Koreans in North China; reduced purchasing power of the agricultural population due to serious floods and so-called communism; over-stimulation of imports in the first half of last year as a result of high exchange and because merchants thought a higher tariff likely to be introduced; and lessening of imports due to lower exchange.

8. Besides there have been heavy emergency expenditures. The flooding of the Yellow and Han Rivers has been very severe, and has given rise to large outlay for relief and rehabilitation. The continued low ebb of economic activity has necessitated continued aid to banks and industrial enterprises. Also there has been need to render aid to provincial and local governments.

9. Large military expenditures have been inescapable for the purpose of coping with the incursions of the so-called communist forces into the Northwest and the Southwest. Moreover the Government has had to increase its outlay for preparations for national defence.

10. Under existing difficult conditions, the Government has been obliged to rely extensively upon borrowing in the domestic market on the best terms obtainable. Since investors in China have not been accustomed to long-term obligations, the usual term of domestic bonds was short, and most domestic bond issues have provided for repayment of principal at the rate of at least 10% in the first year, with complete retirement over five to ten years. A large part of the internal debt was issued with provision for monthly repayment of principal along with interest.

11. There has been a heavy burden each year for repayment of principal of domestic obligations, partly due to the above-mentioned system of internal borrowing, and also because of the relatively large payments for retirement of foreign loans. The following table shows amounts paid during the last five years for debt retirement, (1) compared with the amount of deficit (figures in millions of dollars):

Year ending June 30	Approximate amount of debt retired	Deficit
1931	150	217
32	160	130
33	100	86
34	115	147
35	125	196
<u>Total</u>	<u>650</u>	<u>776</u>

These figures do not include amortization of Boxer indemnity payments, other than those effected for service of loans secured thereon.

12. It is thus apparent that the Government in effect has borrowed largely to retire old debt. This has been a costly process, because the new bonds must be disposed of at a discount and involve relatively high interest cost. Furthermore the new bonds have been short term obligations, with heavy payments in the next few years.

This has involved progressively increasing the extent to which essential current revenues are pledged for debt service.

13. In February, 1932, conditions were so disorganized by the fighting at Shanghai that it became necessary to arrange with the bondholders for a reorganization of the internal debt, which reduced interest rates to a flat 6% per annum, as compared with previous rates as high as 9.6% per annum (8 per mille per month) on some loans, and spread principal payments over a longer period. This measure saved the Government about \$100,000,000 yearly, and this saving together with the strict limitation of payments to actual receipts made it possible to stabilize the national finances during most of the calendar year 1932. This stabilization however does not appear in the table on page 1 above, which is according to fiscal years.

14. From the beginning of 1933 however it became impossible to maintain the strict curtailment of payments. First came the Japanese occupation of Shanhaikwan, shortly followed by the invasion and seizure of Jehol and the overrunning of the greater part of the area from Tientsin and Peiping to the Great Wall. This fighting, which covered most of the latter half of the fiscal year 1932-33, necessitated large expenditures. There was also the cost of giving much needed relief to the refugees of the war zone, and of disbanding and reorganizing various military units in North China. In the autumn of 1933 came the disastrous Yellow River flood, followed by the Fukien rebellion, which was suppressed in January, 1934.

15. Although in 1932 and most of 1933 the Government was able to avoid fresh loan issues, circumstances again made it necessary by the fall of 1933 for the Government again to pledge its revenues for necessary loans. These loans carried with them relatively high

payments for retirement, so that the debt structure at the beginning of 1936 was again in a most unsatisfactory position owing to heavy payments due in the next few years for retiring internal debt. In the six years beginning with 1936 about \$1,000,000,000 of internal debt issues, or about 71% of total internal issues, were due to be retired, or an average of about \$170,000,000 annually. Moreover payments on external obligations remained heavy. The schedule of the Boxer indemnity provided for increased payments beginning in 1932 and continuing at a relatively high figure through 1940. Also the schedule of the American flood relief and cotton and wheat loans requires that repayment of the principal of over US\$20,000,000 outstanding be completed by the latter part of 1937.

16. In January, 1936, the Government and the Bondholders' Association agreed upon the terms of a reorganization of the internal debt, to be effective February 1, 1936. This reorganization included all the outstanding internal bond issues of the National Government excepting six which were affected by special conditions and were less than 10% of the total. Altogether 33 issues were consolidated into five series of bonds running respectively for 12, 15, 18, 21 and 24 years. The total amount of new bonds was \$1,460,000,000. In addition the Government authorized a Recovery Loan of \$340,000,000 issuance of which is expected to be spread over one or two years.

17. This consolidation, while leaving interest rates unchanged at 6%, materially reduced the principal payments in the next few years. Over the next five years it will save about \$85,000,000 yearly, as compared with payments due under the old schedules of the loans now consolidated. Thus the conversion operation materially strengthens the financial position of the Government.

18. The necessity to incur heavy payments for military purposes has been the most serious financial problem confronting the National Government. Military expenditures over the last few years have been as follows:

Year ending June 30	Amount	Percentage of (1) net total payments
1931	\$312,000,000	40.2
32	304,000,000 (2)	40.6
33	321,000,000 (2)	45.9
34	373,000,000 (2)	44.6
35	388,000,000 (2)	41.2

19. China is not a militaristic nation, its people having always been disposed toward adjustment of disputes without employing force. The Government however has been obliged to incur large military expenditures both for maintenance of internal order and as a preparation for national defence.

20. Besides the heavy outlay required to support the troops regularly engaged in the anti-communist and bandit suppression campaigns, the Government has been obliged to appropriate \$5,500,000 monthly as emergency payments. It is also to be noted that the increased figure of payments over the past two or three years results in part from inclusion of figures for payments (and also receipts) for areas for which returns were not previously available, and from transfer to the accounts of the Ministry of Finance of certain military expenditures of an inter-departmental character. Also military expenditures include items for road building, rural rehabilitation and other payments for reconstruction. But even after allowing for the foregoing, military expenditures remain at a high level.

(1) See footnote on page 1.

(2) Including payments made in prior years amounting to \$49,000,000 in 1931-32; \$59,000,000 in 1932-33; \$46,000,000 in 1933-34; and \$58,000,000 in 1934-35.

21. The problem of large military expenditures for internal purposes was inherited by the National Government. The Government earnestly desires to reduce such expenditures and is reorganizing and reducing the numbers of superfluous troops as rapidly as circumstances permit; but if troops are merely disbanded without provision being made for their absorption into productive work, they are likely to drift into banditry or communistic activities. The great necessity is to put in effect the Government's plans of economic reconstruction, thus employing large bodies of laborers on such projects as water conservancy and land reclamation, etc. These projects would not only absorb this surplus labor power but would also increase the productivity of the country and afford increased opportunity for gainful occupation of the people. Moreover, such a program of economic development would promote internal stability and doubtless lessen the necessity for subsidies to provincial and local authorities.

22. Under existing conditions it is obviously impossible to reduce payments for national defence.

23. In the past seven or eight years the National Government has made material progress in developing sources of revenue, through levy of higher customs duties under the regime of tariff autonomy, through rehabilitation and improvement of the Salt Revenue Administration, and through development under the Internal Revenue Administration of the system of consolidated taxes. The following table shows the increase of revenue from these sources by years (figures in millions of dollars):

Fiscal year ended June 30	Customs	Salt	Consolidated taxes	Total
1929	179	30	30 ⁽¹⁾	239 ⁽¹⁾
30	276	122	41	439
31	313	150	53	516
32	370	144	89	603
33	326	158	80	564
34	352	177	105	634
35	353	167	105	625

24. Unfortunately these revenue increases have been largely offset by various adverse developments. The seizure of Manchuria, which was a fruitful source of revenue, occurred during 1931-32, and no provision whatever has been made for payments out of Manchurian customs and salt revenues in respect of the obligations of China secured in part thereon. Moreover, the forcible separation of Manchuria and the establishment of trade barriers has been a very severe blow to the trade and industry of the rest of China, and consequently to Government revenue, since economic intercourse with the Northeastern provinces was highly developed and mutually profitable.

25. Also heavy costs have been incurred in putting down subversive movements, notably the serious civil wars of 1929-31, and in the subsequent anti-communist campaigns. In addition it has been necessary to make large outlays to contend with unusually severe natural calamities - the flood of 1931 alone entailing expenditures of about \$70,000,000, materially impairing public revenues as a result of entailing property losses estimated at \$2,000,000,000 (including crops valued at \$900,000,000). More recently the growth of revenues has been affected by the cumulative effects of the deepening depression. In turn, heavy emergency expenditures have been necessitated by the depression.

(1) Including Kerosene tax now collected by the customs.

26. It should be mentioned that part of the increase in the figures shown in the above table resulted from the progress made in bringing under the administrative control of the Ministry of Finance the revenue collections of various regions. This process however also entailed responsibility for expenditures in amounts somewhat corresponding to the revenues brought under control.

27. Under existing difficult conditions there remains a substantial deficit. Were the rate of deficit indicated by preliminary figures for the six months ended December 31, 1935, to continue through the current fiscal year, the annual deficit would be about \$290,000,000. However, the loan consolidation effected February 1, 1936, makes possible savings at the rate of approximately \$85,000,000 yearly. Also it is expected that customs revenue will increase from the abnormally low figures of last summer. Therefore, the present deficit may be taken to be approximately \$150,000,000 to \$175,000,000 yearly.

28. In the absence of unpredictable developments, however, the reform of the monetary and banking system of November 3, 1935, which is being further developed, is expected to stimulate economic activity so that revenues will increase. Also it is hoped that the need for extraordinary expenditure can be reduced so that the finances can gradually be stabilized.

29. A summary of the position of the national debt is attached as Annex II.

PreliminaryConfidentialCalculation of deficit.

Gross payments		\$ 940,928,456.11
Revenues		<u>744,922,042.20</u>
Gross deficit		196,006,413.91
Adjustment for Capital items		<u>73,500,000.00</u>
Net operating deficit		<u><u>\$ 122,506,413.91</u></u>

Prepared October 14, 1935

General Statement of Cash Receipts and Payments for the Fiscal Year Ending June 30, 1935.

I. Receipts

1. Customs Revenue	\$353,176,774.06
2. Salt Revenue	167,437,077.40
3. Consolidated Taxes	
a. Rolled Tobacco Tax	\$68,133,640.61
b. Cotton Yarn Tax	16,633,721.46
c. Flour Tax	4,786,867.71
d. Match Tax	6,946,167.92
e. Cement Tax	3,056,313.46
f. Cured Tobacco Tax	3,977,664.48
Sub-total	104,660,304.04
4. Tobacco and Wine Taxes	11,484,844.06
5. Stamp Tax	6,914,406.48
6. Mining Tax	4,736,809.20
7. Stock Exchange Tax	136,763.71
8. Tax on Bank Notes Issued	1,613,539.06
9. Government Property Receipts	2,270,593.96
10. Government Enterprise Receipts	60,625,154.55
11. Government Administrative Receipts	10,627,049.06
12. Profit on Government Business Enterprises	1,281,000.00
13. Miscellaneous	80,676,133.07
Total Receipts	\$744,922,042.20

II. Proceeds from Borrowing

1. Domestic Bonds and Treasury Notes	154,390,282.27
2. Bank Loans:	
Total Amount Borrowed	226,442,894.82
Less: Amount Liquidated (-)	145,437,627.40
Net Proceeds from Loans	81,005,267.42
3. Overdrafts:	
Amount Borrowed	207,700,000.00
Less: Amount Liquidated (-)	138,300,000.00
Net Proceeds from Overdrafts	69,400,000.00
4. Cotton-Wheat Loan	25,400,000.00
Total Proceeds from Borrowing	329,195,549.69
Less Repayment of Bank Overdraft from last year	108,000,000.00
Net Proceeds from Borrowing	221,195,549.69
Total Receipts	\$971,117,631.89
Cash Balance at Beginning of the Year	
Depositories	19,307,154.80
Inspector-General of Customs and Subordinate Ports	33,680,544.44
Chief Inspectorate of Salt Revenue and Subordinate Districts	5,401,533.46
Total	58,389,232.69
Total Receipts and Balances at beginning of the year	\$1,030,706,864.58

I. Payments

I. Party	\$6,490,863.88
II. Civil Expenses	
1. Expenses of the National Gov't Council & Organs directly subordinate to it	\$16,448,979.01
2. Interior Affairs Expenses	5,392,408.61
3. Foreign Affairs Expenses	5,703,545.22
4. Financial Affairs Expenses	68,553,542.77
5. Educational & Cultural Affairs Expenses	31,739,487.23
6. Judicial Affairs Expenses	3,727,228.79
7. Industrial Affairs Expenses	6,725,408.94
8. Communication Affairs Expenses	5,582,601.63
9. Mongolian & Tibetan Affairs Expenses	1,669,457.19
10. Reconstruction Affairs Expenses	25,364,620.23
11. Capital for Gov't Business Enterprises	537,200.00
12. Subsidies	85,468,072.42
13. Compensation & Awards	1,557,205.47
14. Famine Relief	700,000.00
Total Civil Expenses	\$254,165,340.50
Less: Refunds	(-13,224,241.66)
Net Payments for Civil Expenses	240,941,098.84
III. Military Expenses	
1. Payments for the present fiscal year	\$330,157,507.30
Less: Refunds	(-) 704.36
Net Amount	\$330,156,802.94
2. Cost of Military Payments for previous years	57,695,033.31
Total Payments for Military Expenses	387,851,836.25
IV. Government Subscription of Bank Capital	\$108,800,000.00
Less: Amounts derived from Surplus and Profits of the Central Bank	(-135,000,000.00)
Net Payments for Bank Capital	73,800,000.00
V. Loan Service	
1. Amortization & Interest, Domestic Bonds	140,862,812.60
2. Amortization & Interest, Foreign Loans	61,651,879.26
3. Amortization & Interest, Bank Loans	21,761,178.53
4. Interest on Bank Overdrafts	8,066,560.00
5. Indemnity, Net Amount	31,718,508.94
6. Commission Charges	164,236.93
7. Debt Readjustments Fund	5,000,000.00
Total Amount of Loan Service	\$269,236,270.26
Less: Refund of principal and interest on bonds and notes held by treasury	(-) 31,788,214.50
Net Amount of Loan Service	237,448,055.76
VI. Net Payments added to Reserve and Suspense Items during the Period	4,784,901.81
Total Payments	940,926,456.11
Cash Balances at end of the year	
Depositories	62,771,877.72
Inspector-General of Customs & Subordinate Ports	50,143,773.60
Chief Inspectorate of Salt Revenue & Subordinate Districts	16,868,537.08
Total	89,784,188.40
Total Payments and Balances at end of the year	\$1,030,706,864.58

Prepared October 14, 1935

SHANGHAI OFFICE
MINISTRY OF FINANCE
15 THE BUND

Strictly confidential

March 11, 1936.

China's monetary policy.

1. The development of a sound and uniform currency system in accordance with the requirements of a modern state and the peculiar needs of China's economy has long been the objective of the Government's monetary policy. The concrete measures taken by the National Government to that end have included the establishment of the Central Bank of China in 1928; the opening of the Central Mint in 1929; the abolition of the tael and the introduction of the standard silver dollar in 1933; adoption of the program of coinage reform; and finally the fundamental currency reform of November, 1935.

2. The introduction of monetary reforms in China is far from simple, in view of the many intricate problems involved. There has long existed in China a wide variety of circulating media, consisting of many kinds of silver and copper coins and of paper currency. Under the old Peking regime, banking developed without sufficient guidance and restriction, and in particular without adequate control of issue of banknotes. Moreover, the existence of foreign settlements and concessions and of extra-territorial privileges greatly complicates the problem, since the Chinese Government is thereby prevented from exercising complete administrative control throughout China's territory, e.g., to combat smuggling and counterfeiting. Also in recent years China has suffered from a piling up of misfortunes through disastrous floods and drought, the threat of communism, and internal and external political friction. In particular, the seizure of the

Northeastern Provinces has dislocated trade and industry, and has injured the position of Government finances because revenue was taken without making available any sums to meet the service of Chinese Government loans secured thereon.⁽¹⁾ To the economic troubles resulting from these misfortunes have been added the effects of the world economic crisis.

3. The economic crisis first led to heavy depreciation of silver, and hence of China's exchange, thus tending to over-stimulate many lines of economic activity in China and to raise the price level. Then in 1931 began the world-wide depreciation in the value of leading currencies, which caused China's exchange to appreciate, accompanied by falling prices and deflation. The index of Shanghai wholesale prices has been as follows:

1926	100.0	1931	126.7
27	104.4	32	112.4
28	101.7	33	103.8
29	104.5	34	97.1
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The high of 130.3 was reached in August, 1931, and the low of 90.5 in July, 1935. The figure for February, 1936, was 105.4.

4. The Government concluded in the fall of 1935 that far-reaching reform of the currency system was the only means to solve the monetary problems, so as to check the disastrous deflation and place the country on a path promising to lead it out of the depression. Therefore the Government promulgated the decree of November 3, 1935, providing for stabilization of exchange at about the level then existing; unification of banknote currency and reserves and making notes of the three Government banks full legal tender; nationalization of silver; reorganization of the Central Bank as the Central

(1) For the five years ending with 1931, the customs revenue collection of the Northeastern Provinces was about 15% of the total.

Reserve Bank on a more independent basis; strengthening the commercial banking system; and balancing the national budget within a period of eighteen months in order to avoid inflation.

5. Adoption of this program of reform checked the deterioration of the economic situation, and has caused definite improvement. The average of Shanghai wholesale prices recovered from 90.5 in July and 94.1 in October, 1935, to 103.3 in November and to 105.4 in February, 1936. Export trade has increased in a gratifying manner, and for the first time in about 60 years exports exceeded imports in December and January as shown by the customs returns now at hand. Also customs revenue has picked up somewhat, and in February after several months of deficit registered a surplus after taking care of loan service secured thereon. Also the Lunar New Year settlement at the end of January was accomplished smoothly and without any disturbance in the markets. Exchange has enjoyed a stability never before known in China. The way has been cleared for continuing betterment of conditions, by doing away with previous uncertainties affecting the monetary situation. Were it not for the acute international situation, the Chinese economy would be in a position better to utilize the improved facilities which are being provided and to progress steadily beyond what has yet been known in China.

6. The Government is actively proceeding with consolidation of the advance already achieved, and is progressing with the measures required to give effect to the policy and program adopted. Circulation of the new nickel and copper coins of 20, 10, 5, 1 and $\frac{1}{2}$ cent denominations began February 10, and the Central Mint is working on day and night shifts so that the new coins are being produced at the rate of about 40,000,000 pieces monthly, about half the output being

nickel and half copper. However, the minting and distribution of a quantity of the new coins sufficient to replace the miscellaneous currency consisting of paper notes and depreciated coins is a matter of years.

7. Adoption of a 50-cent silver coin is under active consideration by the Government. The quantity of silver to be placed in such a coin, however, has not yet been decided. The coin would of course be a token coin, with a bullion value less than its monetary value. The silver content should not be so great that there would be risk of melting in the event of such an increase in the world price of silver as might be reasonably anticipated. On the other hand, the silver content should not be so small as to offer undue temptation to counterfeiters. In China counterfeiting is a very serious problem because of the cheapness of labor and the skill and ingenuity of artisans. Moreover the system of extra-territoriality prevents the Government from taking police action against foreign nationals that might engage in counterfeiting as has been frequently the case in the past.

8. Concrete plans for reorganization of the Central Bank have been proposed by the Minister of Finance, and it is expected that such plans will shortly be adopted by the Government. These proposals contemplate the creation of a new Central Reserve Bank to take place of the Central Bank of China. The Reserve Bank would be a more independent institution with 30% of the shares held by banks, 30% by the public and 40% by the Government. It would be given within two years a monopoly of note issue, to which end transitional measures are being devised. In general it would be developed into an institution which would perform the principal functions of central

banking as exercised by central banking institutions in many other countries.

9. In addition plans are being prepared to create a mortgage bank, in order to assist in unfreezing the banking situation.

10. Since adoption of the reform of November 3, 1935, there has been material progress toward centralization of the monetary and banking system under the newly-created Currency Reserve Board. The silver stocks taken over immediately after the decree of November 3, 1935, were about \$287,000,000. The Currency Reserve Board as of March 7, 1936, held silver reserves of \$369,000,000, an increase of \$82,000,000. Adding about \$66,000,000 exported to the United States under the agreement for sale of 50,000,000 ounces, the amount of silver acquired under the decree has increased by approximately \$148,000,000 since November 3, 1935. Since the beginning of 1936, silver stocks have been increasing at the average rate of about \$6,000,000 weekly, as will be seen from the table annexed as Annex I.

11. Since November 3, 1935, note issue of the three banks has increased from \$427,000,000 to \$708,000,000 as of March 7, 1936, an increase of about \$281,000,000. This increase is partly in exchange for about \$148,000,000 of silver delivered as mentioned above, and partly in substitution for notes of other banks retired. The circulation of other banks as of November 3, 1935, was approximately \$240,000,000, of which about \$79,000,000 had been retired up to February 29, 1936.

12. There are attached as Annexes II and III statements showing the details of note issues, and reserves of The Central Bank of China, the Bank of China, and the Bank of Communications, as of February 29, 1936; and also showing the position of note issues of other banks.

13. Since November 3, 1935, exchange stability has been maintained in spite of several speculative attacks. Maintenance of this stability has been materially aided by the transaction of November for sale of 50,000,000 ounces of silver, which has greatly strengthened the currency reserves providing reserves equivalent to about \$100,000,000, Chinese currency.

14. The note circulation was as follows as of February 29, 1936:

	<u>Amount</u>	<u>Percent</u>
Central Bank of China, Bank of China, and Bank of Communications	\$700,046,382.42	81
Others (1)	<u>161,078,468.20</u>	<u>19</u>
<u>Total</u>	<u>\$861,124,850.62</u>	<u>100</u>

15. The note issues of the three Government banks were secured as of February 29, 1936, by gold, silver and foreign exchange to the extent of about two-thirds, as follows:

	<u>Amount</u>	<u>Percentage of reserves to note issue</u>
Total note issue	\$700,046,382.42	
Silver	\$315,469,453.76	45.1
Gold	35,986,518.76	5.1
Foreign exchange	<u>112,267,189.50</u>	<u>16.0</u>
<u>Total</u>	<u>\$463,723,162.02</u>	<u>66.2</u>

16. In the case of note issue of other than the three banks, no cash reserves were held other than silver and bank deposits within China. The total amount of silver stocks held by the three banks as reported to the Currency Reserve Board as of February 29, 1936, was \$364,044,089.26. This figure includes the silver holdings of the

(1) Including figures for the Farmers' Bank as of March 4, 1936.

three banks against their note issues (i.e., the above \$315,469,453.76). The difference of about \$49,000,000 may be taken to represent approximately the reserves of silver held in respect of the notes still in circulation of other banks.

17. Thus, in relation to total note issue of about \$861,000,000, total reserves of silver, gold and foreign exchange were about \$512,000,000 or approximately 60%. Silver holdings (about \$364,000,000) were 71% of total note issue reserves, and total gold and foreign exchange (about \$148,000,000) were 29%. The distribution as between gold and silver may be contrasted with that of the American currency reserves, which are understood to consist of something over 80% in gold and less than 20% in silver (monetary value).

18. The Chinese Government has a vital interest in the future of silver, not only by reason of the amount of \$369,000,000 of silver reserves held under the Currency Reserve Board, which amount is steadily increasing, but also because silver constitutes a principal asset upon which the Government must rely for the purpose of defending the stability of its currency. The Government's policy as to exchange is stated as follows in Article 6 of the decree of November 3, 1935:⁽¹⁾

"For the purpose of keeping the exchange value of the Chinese dollar stable at its present level, The Central Bank of China, The Bank of China and The Bank of Communications shall buy and sell foreign exchange in unlimited quantities."

19. In carrying out this policy the Government must rely on holdings of gold and foreign exchange. So far the three Government banks have been able to meet all calls. But if for any reason a demand for foreign currency should arise which would exhaust the reserves of foreign exchange and gold, the silver portion of the

(1) See Annex IV, "The New Monetary Policy of China", containing the text of recent currency measures.

reserves would not be of assistance in supporting the exchange unless it could be converted into foreign currency.

20. In view of this situation it can readily be appreciated that under existing conditions the Chinese Government would be seriously affected in the event of a fall in the world price of silver below approximately US\$0.40 per fine ounce, which corresponds with the parity of the Chinese silver dollar. Should silver approach close to that level, lack of confidence in the Chinese currency would immediately develop in China, since this condition would involve the depreciation of the value of the principal element which backs the currency. A flight of capital would tend to ensue. There would also be heavy speculative buying of foreign currencies, particularly for forward delivery, which the governmental authorities would not be able effectively to control in view of the existence of the foreign settlements and concessions, and in view of the extra-territorial privileges of the foreign financial institutions and foreign nationals who are not subject to Chinese authority.

21. Now that China for the first time in its history has achieved exchange stability, and at a level which is deemed to be in keeping with the requirements of its economic situation, the Chinese Government is extremely anxious that this stability shall be maintained. If in future an international understanding for currency stabilization is reached, China would be glad to cooperate, and to maintain a monetary system in harmony therewith. As a holder of silver, however, China would favor in principle an international agreement whereby silver would be given a definite status as primary money such as would permit it being imported and exported at times when international bullion movements are necessary.

Note Issue and Silver Holdings of The Three Government Banks⁽¹⁾

Date	Note Issue				Silver stocks held by the three banks
	Central Bank	Bank of China	Bank of Communications	Total	
	(In millions of dollars)				237 ⁽²⁾
Nov. 2, 1935	136	187	105	427	
9,	140	202	114	456	
16	144	-	123	-	
20	-	231	-	-	
23	146	-	133	-	
30	151	249	142	542	
Dec. 7, 1935	158	-	-	-	
10	-	258	149	-	
14	167	-	157	-	
21	168	272 ⁽³⁾	162	602 ⁽³⁾	
28	176	-	169	-	
31	179	286	176	641	
Jan. 4, 1936	179	290	175	644	315
11	185	294	178	656	320
18	191	303	181	676	327
25	221	308	191	719	335
Feb. 1, 1936	225	306	192	723	341
8	230	303	191	724	346
15	232	296	186	713	350
22	230	288	182	700	357
29	224	293	182	700	364
Mar. 7, 1936	232	294	181	708	369

(1) For November and December, 1935, the Bank of China figures are derived from reports each ten days.

(2) This includes \$219,260,000 at Shanghai and \$67,310,000 at out-ports, the latter figure being derived from reports to the Currency Reserve Board by offices of the Ministry of Finance. Sales of silver to the U.S. were about \$66,000,000, shipped in late December and early January. If this amount had not been exported, the three banks' total silver holdings as of Feb. 29, 1936, would have been about \$430,000,000. This figure exceeds by \$143,000,000 the total as of Nov. 2, 1935.

(3) Bank of China figures as of December 20, 1935, are here included.

Annex IITOTAL NOTE ISSUES AND ITEMIZED CASH RESERVES

(as of February 29, 1936.)

NAMES OF BANKS	CENTRAL BANK	BANK OF CHINA	BANK OF COMMUNICATIONS	TOTAL
TOTAL AMOUNT ISSUED	224,324,443.00	293,838,239.42	181,883,700.00	700,046,382.42
Cash Reserves:				
Silver Dollars	98,275,179.40	152,063,079.29	51,567,526.00	301,905,784.69
Silver Bullion	13,065,123.00	843.64	497,702.43	13,563,669.07
Foreign Currencies	13,913,386.85	59,815,881.07	38,537,921.58	112,267,189.50
Gold	13,439,073.75	9,995,311.10	12,552,133.91	35,986,518.76
Joint Reserve Notes			316,043.08	316,043.08
Deposits With Other Banks	4,269,000.00	4,987,697.27		9,256,697.27
Joint Treasury Notes			2,730,000.00	2,730,000.00
Vault Receipt			2,000,000.00	2,000,000.00
Custody Receipt			299,496.00	299,496.00
Notes of Other Banks	10,320,000.00		16,500,000.00	26,820,000.00
TOTAL	153,281,763.00	226,862,812.37	125,000,823.00	505,145,398.37

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March 13, 1936.

Annex IIINote issues of other than those of The Central Bank of China, The Bank of China, and The Bank of Communications.

	<u>Outstanding Nov. 3, 1935</u>
The Industrial Bank of China	\$ 54,211,809.00
The National Commercial Bank	9,448,773.00
Ningpo Commercial & Savings Bank	19,220,800.00
The Land Bank of China	7,496,000.00
The Agricultural & Industrial Bank of China	16,454,517.00
The Commercial Bank of China	28,608,000.00
The Bank of Agriculture & Commerce	2,824,300.00
China & South Seas Bank (Joint Treasury)	72,282,400.00
Farmers' Bank	29,893,207.00
Total outstanding Nov. 3, 1935	\$240,439,806.00
Less:	
Amount retired Nov. 3, 1935 to Feb. 29, 1936	79,361,337.80 (1)
	<u>\$161,078,468.20</u>

(1) Figures for Farmers' Bank as of March 4, 1936.

MINISTRY OF FINANCE

Personal & strictly confidentialShanghai
March 13, 1936The Honorable Henry Morgenthau
Secretary of the Treasury
Washington, D.C.
U. S. A.

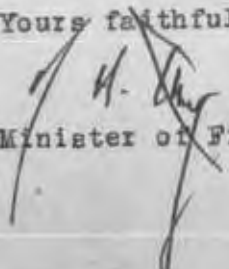
Dear Mr. Secretary:

I deeply appreciate the sympathetic personal interest which you are taking in China's finances. In order that you may be fully informed as to the actual financial position of the Chinese Government, I am asking Mr. K. P. Chen to hand you this letter and the attached memorandum entitled "The financial position of the Chinese Government".

In view of the nature of this memorandum, which contains confidential data and also certain information not yet reported by me to the Government, I desire to request you to regard it as for your own private and confidential information, and not to place this letter and the enclosure in the official files of the American Government. I should of course be glad to have you communicate to the President such of these data as you think he might care to have.

I want you to feel that you can call upon Mr. Chen for all material information concerning China's financial situation.

Yours faithfully,


Minister of Finance.

Enclosure:

As stated above.

Strictly confidential

March 11, 1936.

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2. The introduction of monetary reforms in China is far from simple, in view of the many intricate problems involved. There has long existed in China a wide variety of circulating media, consisting of many kinds of silver and copper coins and of paper currency. Under the old Peking regime, banking developed without sufficient guidance and restriction, and in particular without adequate control of issue of banknotes. Moreover, the existence of foreign settlements and concessions and of extra-territorial privileges greatly complicates the problem, since the Chinese Government is thereby prevented from exercising complete administrative control throughout China's territory. e.g., to combat smuggling and counterfeiting. Also in recent years China

has suffered from a piling up of misfortunes through disastrous floods and drought, the threat of communism, and internal and external political friction. In particular, the seizure of the Northeastern Provinces has dislocated trade and industry, and has injured the position of Government finances because revenue was taken without making available any sums to meet the service of Chinese Government loans secured thereon.⁽¹⁾ To the economic troubles resulting from these misfortunes have been added the effects of the world economic crisis.

3. The economic crisis first led to heavy depreciation of silver, and hence of China's exchange, thus tending to over-stimulate many lines of economic activity in China and to raise the price level. Then in 1931 began the world-wide depreciation in the value of leading currencies, which cause China's exchange to appreciate, accompanied by falling prices and deflation. The index of Shanghai wholesale prices has been as follows:

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Note Issue and Silver Holdings of The Three Government Banks (1)

Date	Note Issue				Silver stocks held by the three banks
	Central Bank	Bank of China	Bank of Communications	Total	
		(In millions of dollars)			
Nov. 2, 1935	136	187	105	427	237(2)
9,	140	202	114	456	
16	144	-	123	-	
20	-	231	-	-	
23	146	-	133	-	
30	151	249	142	542	
Dec. 7, 1935	158	-	-	-	602(3)
10	-	258	149	-	
14	167	-	157	-	
21	168	272(3)	162	602(3)	
28	176	-	169	-	
31	179	286	176	641	
Jan. 4, 1936	179	290	175	644	315
11	185	294	178	656	320
18	191	303	181	676	327
25	221	308	191	719	335
Feb. 1, 1936	225	306	192	723	341
8	230	303	191	724	346
15	232	296	186	713	350
22	230	288	182	700	357
29	224	293	182	700	364
Mar. 7, 1936	232	294	181	708	369

(1) For November and December, 1935, the Bank of China figures are derived from reports each ten days.

(2) This includes \$219,260,000 at Shanghai and \$67,310,000 at out-ports, the latter figure being derived from reports to the Currency Reserve Board by offices of the Ministry of Finance. Sales of silver to the U.S. were about \$66,000,000, shipped in late December and early January. If this amount had not been exported, the three banks' total silver holdings as of Feb. 29, 1936, would have been about \$430,000,000. This figure exceeds by \$143,000,000 the total as of Nov. 2, 1935.

(3) Bank of China figures as of December 20, 1935, are here included.

Shanghai, March 7, 1936.

Annex II
TOTAL NOTE ISSUES AND ITEMIZED CASH RESERVES
(as of February 29, 1936.)

NAMES OF BANKS	CENTRAL BANK	BANK OF CHINA	BANK OF COMMUNICATIONS	TOTAL
TOTAL AMOUNT ISSUED	224,324,443.00	293,838,239.42	181,883,700.00	700,046,382.42
Cash Reserves:				
Silver Dollars	98,275,179.40	152,063,079.29	51,567,526.00	301,905,784.69
Silver Bullion	13,065,123.00	843.64	497,702.43	13,563,669.07
Foreign Currencies	13,913,386.85	59,815,881.07	38,537,921.58	112,267,189.50
Gold	13,439,073.75	9,995,311.10	12,552,133.91	35,986,518.76
Joint Reserve Notes			316,043.08	316,043.08
Deposits With Other Banks	4,269,000.00	4,987,697.27		9,256,697.27
Joint Treasury Notes			2,730,000.00	2,730,000.00
Vault Receipt			2,000,000.00	2,000,000.00
Custody Receipt			299,496.00	299,496.00
Notes of Other Banks	10,320,000.00		16,500,000.00	26,820,000.00
TOTAL	153,281,763.00	226,862,812.37	125,000,823.00	505,145,398.37

March 13, 1936.

Annex III

Note issues of other than those of The Central
Bank of China, The Bank of China, and The
Bank of Communications.

	Outstanding Nov. 3, 1935
The Industrial Bank of China	\$ 54,211,809.00
The National Commercial Bank	9,448,773.00
Ningpo Commercial & Savings Bank	19,220,800.00
The Land Bank of China	7,496,000.00
The Agricultural & Industrial Bank of China	16,454,517.00
The Commercial Bank of China	28,608,000.00
The Bank of Agriculture & Commerce	2,824,300.00
China & South Seas Bank (Joint Treasury)	72,282,400.00
Farmers' Bank	29,893,207.00
Total outstanding Nov. 3, 1935	\$240,439,806.00
Less:	
Amount retired Nov. 3, 1935 to Feb. 29, 1936	79,361,337.80 (1)
	<u>\$161,078,468.20</u>

(1) Figures for Farmers' Bank as of March 4, 1936.

Shanghai Office
MINISTRY OF FINANCE
15 The Bund

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March 9, 1936.

Strictly confidential

Enclosure

Memorandum

The financial position of the Chinese Government

1. In connection with the monetary reform adopted November 3, 1935, the Government adopted a program of balancing the budget in 18 months. Such a program was deemed essential in order to avoid jeopardizing the currency through inflation resulting from continued borrowing, especially from the banks. In carrying out that program, however, the Government has been meeting with serious difficulties because of falling revenues, particularly customs, and the impossibility under existing conditions of materially reducing expenditure.

2. The following statement compares net total revenues and payments during the past five years (figures in millions of dollars), as reported by the Accounts Department of the Ministry of

Finance:

Year ending June 30	Net total pay- ments (exclud- ing cash bal- ances at end of year) (1)	Net total rev- enue (excluding net proceeds from borrowing) (1)	Deficit	Percentage of deficit to payments (1)
1931	774	557	217	28.0
32	749	619	130	17.4
33	699	613	86	12.2
34	836	689	147	17.6
35	941	745	196	20.8

(1) The figures shown in this table differ from those given in

3. The financial results of the fiscal year 1934-35 are shown in detail in Annex 1. The following is a summary:

(Millions of dollars)

Revenue:

Customs	353
Salt	167
Consolidated taxes	105
Tobacco and wine taxes	11
Government enterprise receipts (largely from railways)	61
Other	48
Total	745

Payments:

Party and civil expenses	237
Military expenses (including \$58,000,000 representing cost of military payments for previous years)	388
Government subscription of bank capital (net)	74
Loan service (including foreign loans and indemnities, \$93,000,000; domestic loans (net) \$139,000,000; and debt readjustment fund \$5,000,000)	237
Net additions to reserve and suspense items	5
Total	941

4. Calculation of deficit.

Gross payments	\$940,928,456.11
Revenues	<u>744,922,042.20</u>
Gross deficit	196,006,413.91
Adjustment for capital items	<u>73,500,000.00</u>
Net operating deficit	\$122,506,413.91

published reports of the Ministry of Finance, in that the Department of Accounts has now adopted the practice heretofore followed by the Directorate General of Budget, Accounts and Statistics in showing costs of revenue collection under payments to the Ministry of Finance instead of as a deduction from revenue. Hence the figures for 1931-34 have been revised on this basis.

5. The above-mentioned "Adjustment for capital items, \$73,500,000" is the net amount of additional funds provided by the Government for subscription of bank capital in order to meet the emergency conditions which existed during a large part of the last fiscal year.

6. During the current fiscal year 1935-36 the deficit has been at a higher rate than in 1934-35, and according to preliminary figures was about \$146,000,000 for the six months ended December 31, 1935. The increased deficit resulted from various causes.

7. There has been a material decrease of customs revenue in the last eight or nine months. This is due to various conditions: the disturbed international situation which discourages import commitments; wholesale smuggling by Japanese and Koreans in North China; reduced purchasing power of the agricultural population due to serious floods and so-called communism; over-stimulation of imports in the first half of last year as a result of high exchange and because merchants thought a higher tariff likely to be introduced; and lessening of imports due to lower exchange.

8. Besides there have been heavy emergency expenditures. The flooding of the Yellow and Han Rivers has been very severe, and has given rise to large outlay for relief and rehabilitation. The continued low ebb of economic activity has necessitated continued aid to banks and industrial enterprises. Also there has been need to render aid to provincial and local governments.

9. Large military expenditures have been inescapable for the purpose of coping with the incursions of the so-called communist forces into the Northwest and the Southwest. Moreover the Government has had to increase its outlay for preparations for national defence.

10. Under existing difficult conditions, the Government has been obliged to rely extensively upon borrowing in the domestic market on the best terms obtainable. Since investors in China have not been accustomed to long-term obligations, the usual term of domestic bonds was short, and most domestic bond issues have provided for repayment of principal at the rate of at least 10% in the first year, with complete retirement over five to ten years. A large part of the internal debt was issued with provision for monthly repayment of principal along with interest.

11. There has been a heavy burden each year for repayment of principal of domestic obligations, partly due to the above-mentioned system of internal borrowing, and also because of the relatively large payments for retirement of foreign loans. The following table shows amounts paid during the last five years for debt retirement, (1) compared with the amount of deficit (figures in millions of dollars):

<u>Year ending</u> <u>June 30</u>	<u>Approximate amount</u> <u>of debt retired</u>	<u>Deficit</u>
1931	150	217
32	160	130
33	100	86
34	115	147
35	125	196
<u>Total</u>	<u>650</u>	<u>776</u>

These figures do not include amortization of Boxer indemnity payments, other than those effected for service of loans secured thereon.

12. It is thus apparent that the Government in effect has borrowed largely to retire old debt. This has been a costly process, because the new bonds must be disposed of at a discount and involve relatively high interest cost. Furthermore the new bonds have been short term obligations, with heavy payments in the next few years.

This has involved progressively increasing the extent to which essential current revenues are pledged for debt service.

13. In February, 1932, conditions were so disorganized by the fighting at Shanghai that it became necessary to arrange with the bondholders for a reorganization of the internal debt, which reduced interest rates to a flat 6% per annum, as compared with previous rates as high as 9.6% per annum (8 per mille per month) on some loans, and spread principal payments over a longer period. This measure saved the Government about \$100,000,000 yearly, and this saving together with the strict limitation of payments to actual receipts made it possible to stabilize the national finances during most of the calendar year 1932. This stabilization however does not appear in the table on page 1 above, which is according to fiscal years.

14. From the beginning of 1933 however it became impossible to maintain the strict curtailment of payments. First came the Japanese occupation of Shannhaikwan, shortly followed by the invasion and seizure of Jehol and the overrunning of the greater part of the area from Tientsin and Peiping to the Great Wall. This fighting, which covered most of the latter half of the fiscal year 1932-33, necessitated large expenditures. There was also the cost of giving much needed relief to the refugees of the war zone, and of disbanding and reorganizing various military units in North China. In the autumn of 1933 came the disastrous Yellow River flood, followed by the Fukien rebellion, which was suppressed in January, 1934.

15. Although in 1932 and most of 1933 the Government was able to avoid fresh loan issues, circumstances again made it necessary by the fall of 1933 for the Government again to pledge its revenues for necessary loans. These loans carried with them relatively high

payments for retirement, so that the debt structure at the beginning of 1936 was again in a most unsatisfactory position owing to heavy payments due in the next few years for retiring internal debt. In the six years beginning with 1936 about \$1,000,000,000 of internal debt issues, or about 71% of total internal issues, were due to be retired, or an average of about \$170,000,000 annually. Moreover payments on external obligations remained heavy. The schedule of the Boxer indemnity provided for increased payments beginning in 1932 and continuing at a relatively high figure through 1940. Also the schedule of the American flood relief and cotton and wheat loans requires that repayment of the principal of over US \$20,000,000 outstanding be completed by the latter part of 1937.

16. In January, 1936, the Government and the Bondholders' Association agreed upon the terms of a reorganization of the internal debt, to be effective February 1, 1936. This reorganization included all the outstanding internal bond issues of the National Government excepting six which were affected by special conditions and were less than 10% of the total. Altogether 33 issues were consolidated into five series of bonds running respectively for 12, 15, 18, 21 and 24 years. The total amount of new bonds was \$1,460,000,000. In addition the Government authorized a Recovery Loan of \$340,000,000 issuance of which is expected to be spread over one or two years.

17. This consolidation, while leaving interest rates unchanged at 6%, materially reduced the principal payments in the next few years. Over the next five years it will save about \$85,000,000 yearly, as compared with payments due under the old schedules of the loans now consolidated. Thus the conversion operation materially strengthens the financial position of the Government.

18. The necessity to incur heavy payments for military purposes has been the most serious financial problem confronting the National Government. Military expenditures over the last few years have been as follows:

Year ending June 30	Amount	Percentage of (1) net total payments
1931	\$312,000,000	40.2
32	304,000,000 (2)	40.6
33	321,000,000 (2)	45.9
34	373,000,000 (2)	44.6
35	388,000,000	41.2

19. China is not a militaristic nation, its people having always been disposed toward adjustment of disputes without employing force. The Government however has been obliged to incur large military expenditures both for maintenance of internal order and as a preparation for national defence.

20. Besides the heavy outlay required to support the troops regularly engaged in the anti-communist and bandit suppression campaigns, the Government has been obliged to appropriate \$5,500,000 monthly as emergency payments. It is also to be noted that the increased figure of payments over the past two or three years results in part from inclusion of figures for payments (and also receipts) for areas for which returns were not previously available, and from transfer to the accounts of the Ministry of Finance of certain military expenditures of an inter-departmental character. Also military expenditures include items for road building, rural rehabilitation and other payments for reconstruction. But even after allowing for the foregoing, military

expenditures remain at a high level.

- (1) See footnote on page 1.
- (2) Including payments made in prior years amounting to \$49,000,000 in 1931-32; \$59,000,000 in 1932-33; \$48,000,000 in 1933-34; and \$58,000,000 in 1934-35.

21. The problem of large military expenditures for internal purposes was inherited by the National Government. The Government earnestly desires to reduce such expenditures and is reorganizing and reducing the numbers of superfluous troops as rapidly as circumstances permit; but if troops are merely disbanded without provision being made for their absorption into productive work, they are likely to drift into banditry or communistic activities. The great necessity is to put in effect the Government's plans of economic reconstruction, thus employing large bodies of laborers on such projects as water conservancy and land reclamation, etc. These projects would not only absorb this surplus labor power but would also increase the productivity of the country and afford increased opportunity for gainful occupation of the people. Moreover, such a program of economic development would promote internal stability and doubtless lessen the necessity for subsidies to provincial and local authorities.

22. Under existing conditions it is obviously impossible to reduce payments for national defence.

23. In the past seven or eight years the National Government has made material progress in developing sources of revenue, through levy of higher customs duties under the regime of tariff autonomy, through rehabilitation and improvement of the Salt Revenue

Administration, and through development under the Internal Revenue Administration of the system of consolidated taxes. The following table shows the increase of revenue from these sources by years (figures in millions of dollars):

Fiscal year ended June 30	Customs	Salt	Consolidated taxes	Total
1929	179	30	30 (1)	239 (1)
30	276	122	41	439
31	313	150	53	516
32	370	144	89	603
33	326	158	80	564
34	352	177	105	634
35	353	167	105	625

24. Unfortunately these revenue increases have been largely offset by various adverse developments. The seizure of Manchuria, which was a fruitful source of revenue, occurred during 1931-32, and no provision whatever has been made for payments out of Manchurian customs and salt revenues in respect of the obligations of China secured in part thereon. Moreover, the forcible separation of Manchuria and the establishment of trade barriers has been a very severe blow to the trade and industry of the rest of China, and consequently to Government revenue, since economic intercourse with the Northeastern provinces was highly developed and mutually profitable.

25. Also heavy costs have been incurred in putting down subversive movements, notably the serious civil wars of 1929-31, and in the subsequent anti-communist campaigns. In addition it has been necessary to make large outlays to contend with unusually severe natural calamities - the flood of 1931 alone entailing expenditures of about \$70,000,000, materially impairing public revenues as a result

of entailing property losses estimated at \$2,000,000,000 (including crops valued at \$900,000,000). More recently the growth of revenues has been affected by the cumulative effects of the deepening depression. In turn, heavy emergency expenditures have been necessitated by the depression.

(i) Including Kerosene tax now collected by the customs.

26. It should be mentioned that part of the increase in the figures shown in the above table resulted from the progress made in bringing under the administrative control of the Ministry of Finance the revenue collections of various regions. This process however also entailed responsibility for expenditures in amounts somewhat corresponding to the revenues brought under control.

27. Under existing difficult conditions there remains a substantial deficit. Were the rate of deficit indicated by preliminary figures for the six months ended December 31, 1935, to continue through the current fiscal year, the annual deficit would be about \$290,000,000. However, the loan consolidation effected February 1, 1936, makes possible savings at the rate of approximately \$85,000,000 yearly. Also it is expected that customs revenue will increase from the abnormally low figures of last summer. Therefore, the present deficit may be taken to be approximately \$150,000,000 to \$175,000,000 yearly.

28. In the absence of unpredictable developments, however, the reform of the monetary and banking system of November 3, 1935, which is being further developed, is expected to stimulate economic activity so that revenues will increase. Also it is hoped that the need for

extraordinary expenditure can be reduced so that the finances can gradually be stabilized.

29. A summary of the position of the national debt is attached as Annex II.

Confidential

Confidential

Calculation of deficit.

Gross payments	\$ 940,928,456.11
Revenues	<u>744,922,042.20</u>
Gross deficit	196,006,413.91
Adjustment for Capital items	<u>73,500,000.00</u>
Net operating deficit	<u>\$ 122,506,413.91</u>

Prepared October 14, 1935

General Statement of Cash Receipts and Payments for the Fiscal Year Ending June 30, 1935.

(Receipts)

I. Revenue

1. Customs Revenue	\$353,175,774.95
2. Salt Revenue	167,437,077.40
3. Consolidated Taxes	
a. Rolled Tobacco Tax	\$59,133,549.51
b. Cotton Yarn Tax	15,633,721.46
c. Flour Tax	4,786,267.71
d. Match Tax	8,849,107.92
e. Cement Tax	3,082,313.43
f. Cured Tobacco Tax	3,977,564.48
Sub-total	104,566,334.04
4. Tobacco and Wine Taxes	11,484,844.06
5. Stamp Tax	6,914,406.46
6. Mining Tax	4,232,269.30
7. Stock Exchange Tax	139,763.71
8. Tax on Bank Notes Issued	1,613,539.06
9. Government Property Receipts	2,270,595.96
10. Government Enterprise Receipts	50,503,154.53
11. Government Administrative Receipts	10,627,049.06
12. Profit on Government Business Enterprises	1,281,080.00
13. Miscellaneous	20,876,133.07

Total Revenue

II. Proceeds from Borrowing

1. Domestic Bonds and Treasury Notes	154,390,292.27
2. Bank Loans:	
Total Amount Borrowed	228,442,894.82
Less: Amount Liquidated	(-) 145,437,597.40
Net Proceeds from Loans	83,005,297.42
3. overdrafts:	
Amount Borrowed	207,700,000.00
Less: Amount Liquidated	(-) 152,300,000.00
Net Proceeds from Overdrafts	55,400,000.00
4. Cotton-Wheat Loan	25,400,000.00
Total Proceeds from Borrowing	328,195,589.69
Less: Repayment of Bank Overdraft from last year	108,000,000.00
Net Proceeds from Borrowing	220,195,589.69

Total Receipts

Cash Balance at Beginning of the Year

Depositories	19,307,154.50
Inspectorate-General of Customs and Subordinate Ports	55,880,544.44
Chief Inspectorate of Salt Revenue and Subordinate Districts	6,401,533.45
Total	80,589,232.39
Total Receipts and Balances at beginning of the year	\$1,030,706,964.58

(Payments)

I. Party

\$5,420,863.57

II. Civil Expenses

1. Expenses of the National Gov't Council & Organs directly subordinate to it	\$16,448,979.01
2. Interior Affairs Expenses	5,395,403.51
3. Foreign Affairs Expenses	9,703,346.32
4. Financial Affairs Expenses	\$8,553,342.77
5. Educational & Cultural Affairs Expenses	31,732,467.23
6. Judicial Affairs Expenses	3,727,229.72
7. Industrial Affairs Expenses	5,725,402.94
8. Communication Affairs Expenses	5,583,491.63
9. Mongolian & Tibetan Affairs Expenses	1,669,457.19
10. Reconstruction Affairs Expenses	26,364,620.26
11. Capital for Gov't Business Enterprises	537,200.00
12. Subsidies	55,488,072.42
13. Compensation & Awards	1,257,205.47
14. Famine Relief	700,000.00
Total Civil Expenses	\$254,163,540.59
Less: Refunds	(-) 13,284,241.55
Net Payments for Civil Expenses	230,868,399.04

III. Military Expenses

1. Payments for the present fiscal year	\$330,157,607.30
Less: Refunds	(-) 704.32
Net Amount	\$330,156,902.98
2. Cost of Military Payments for previous years	57,656,036.22
Total Payments for Military Expenses	387,812,939.20

IV. Government Subscription of Bank Capital

Less: Amounts derived from Surplus and Profits of the Central Bank	(-) 135,000,000.00
	73,900,000.00

V. Loan Service

1. Amortization & Interest, Domestic Bonds	140,862,812.60
2. Amortization & Interest, Foreign Loans	61,661,679.26
3. Amortization & Interest, Bank Loans	21,761,172.53
4. Interest on Bank Overdrafts	6,086,560.00
5. Indemnity, Net Amount	31,718,606.94
6. Commission Charges	164,539.93
7. Debt Readjustments Fund	5,000,000.00
Total Amount of Loan Service	\$260,255,870.26
Less: Refund of principal and interest on bonds and notes held by treasury	(-) 51,725,914.59
Net Amount of Loan Service	208,529,955.67

VI. Net Payments added to Reserve and Suspense Items during the Period

	4,784,901.81
Total Payments	940,926,456.11

Cash Balances at end of the year

Depositories	22,771,877.72
Inspector-General of Customs & Subordinate Ports	50,143,775.60
Chief Inspectorate of Salt Revenue & Subordinate Districts	16,262,857.06
Total	89,178,500.47

Total Payments and Balances at end of the year

Prepared October 14, 1935

CONFERENCE ON THE CANADIAN LIQUOR SITUATION
Thursday, April 9, 1936

There were present in the Secretary's office, in addition to the Secretary, Mr. McReynolds, Mr. Taylor, Mr. Gaston, Mr. Frank, Mr. Klaus, Mr. Green and Mr. Graves. The conference opened shortly after 11.30 A.M.

Mr. Graves handed to the Secretary a memorandum entitled "Basis for Acceptance by the Treasury of the Proposals Made by Secretary Hull at the Conference with Secretary Morgenthau on Tuesday, April 7, Regarding the Canadian Distillery Cases", and explained that the memorandum had the approval of Mr. Oliphant and himself. After an explanation of the meaning of the terms by Mr. Graves the Secretary inquired who would represent the Treasury in negotiations with the Canadians, stating that he himself would not meet them. Mr. Graves replied that the question as to who would represent the Treasury had not been gone into. Upon the Secretary's question all persons present with the exception of Mr. Taylor stated that they concurred in the proposals contained in the memorandum. Mr. Taylor, however, raised an objection to Point 5 in the memorandum saying that it would not be right to push this unusual legislation simply because one Canadian company held out against settlement. It was pointed out by the Secretary as well as by others that any other plan would be unfair to those distillers who settled; that otherwise there would be an incentive toward refraining from settlement; and that those who settled had nothing to lose by the passage of the legislation.

Mr. Graves pointed out that the proposals contained in the memorandum were substantially those made by Secretary Hull, with the qualification that we would under no circumstances enter into a discussion of the merits or facts or law of our cases. He pointed out upon the Secretary's question as to what the procedure would be that we would meet the distillers separately and would state to them what our claims were and ask them what proposition they had to make with regard to payment. He pointed out that presumably they would offer a figure that we might reject as being inadequate, and probably no settlement would be arrived at since the Canadians would make no proposal which would be satisfactory to us. We would then proceed to a discussion with them of Paragraph 3, namely, submission to the jurisdiction and providing security. Should we find ourselves unable to come to a satisfactory agreement upon that subject we would then be free to proceed with the legislation.

The Secretary stated his personal views on the subject, solely for the purposes of the present discussion. He asked the lawyers present (excusing Mr. Graves from answering) why Canada had been chosen for this special treatment; why we were not cleaning up cases against our own citizens, such as the Corn Products Refining Co., who sold corn sugar to bootleggers, the domestic manufacturers of stills, local bootleggers, etc., or the actual importers of the liquor smuggled. He asked why we were not proceeding also against citizens of other countries who had been guilty

of the same acts, such as the British or Cubans. He referred to Mr. Klaus' study which showed British domination of the liquor field and which had been in a safe for two years. He recalled how he had stated upon his accession to office that he would stop smuggling and bootlegging or resign, and said that apart from some income tax cases there was no evidence that the Treasury was pursuing these other persons who were equally liable for acts done during Prohibition.

He stated that we were discriminating against Canada because it seemed easier to go after Canada, and called attention to the fact that Canada had given up much revenue by the 1930 Export Act in an attempt to aid us in solving the Prohibition problem.

In reply to the foregoing statements by the Secretary it was pointed out in discussion, chiefly by Mr. Frank and Mr. Klaus, that these investigations began as a result of the Reifel Case which the Secretary had initiated; that representatives of the Canadian distilling interests, feeling themselves guilty, had come to the Treasury Department and asked for a settlement of the claims against them and that the Treasury had replied that until the facts were investigated no settlement would be discussed. The investigations were undertaken with a view to ascertaining what the liability of these Canadians was. It was pointed out that it had taken about eighteen months to acquire the present information with regard to the liability of the Canadians, and further, that while we believed we had cases against British, Cuban, and other interests, it had taken all

of the time of the present investigators to perfect, so far as they have perfected them, the cases against these Canadians which were much more easy to prove than the other cases, and that the importers could not be found or had no assets. It was also pointed out that cases were pending in the Department of Justice against industrial alcohol companies for diversion of industrial alcohol during the Prohibition years and that other investigations were pending in the Department of Justice, and that in many such cases it was difficult to get the necessary proof. It was further pointed out that the fact that we might have cases against other people would not justify us in giving up the cases against the Canadians.

Mr. Klaus pointed out, in answer to the 1930 Export Act argument of the Canadians, mentioned by the Secretary, that they frequently brought this circumstance up as a reason for favors from us and that in fact the Canadian Government had lost nothing as a result of the 1930 Export Act. He referred to the fact that a large body of public opinion compelled the Canadian Government to adopt the 1930 Export Act; that Canadian opinion had revolted against the connivance of the Canadian Government in the smuggling of liquor across the Detroit River in order that the Canadian Government might obtain \$7.00 a gallon on that liquor; that the drawback system of \$7.00 per gallon had given rise to evils in Canada that brought about a pressure of public opinion in favor of the abolition of the drawback system; that the Canadian Government might have saved the \$7.00 per

gallon by abolishing the drawback system entirely but that the Canadian Government, compromising with the distillers, chose to keep the drawback system and at the same time keep the bootleg liquor industry (which might otherwise have moved to other places, such as St. Pierre, etc.) so that while it no longer collected \$7.00 per gallon on liquor shipped across the Detroit River into the United States it got the equivalent (\$15,000,000 per year, as was admitted by the Canadian Charge d'Affaires recently) in the form of income taxes from the Canadian bootleg liquor industry.

He and Mr. Gaston pointed out further that there was no legitimate Canadian liquor industry today except for such small liquor consumption as there was in Canada, that the affiliations with Canada on the part of the distillers were solely technical; that all their business was in the United States except for the whisky stocks which remained in Canada and which the distillers proposed to bring over into the United States, and that the corporations involved had, largely, American stockholders.

Mr. Klaus further pointed out that the political repercussions in dropping the legislation might be embarrassing. He referred to the fact that all during Prohibition these Canadians had avoided prosecution by staying out of the United States; that the Hiram Walker people, for example, had been indicted in Buffalo and later, while this Administration was in power and Repeal had come, the Hiram Walker people had their

indictments nolle prossed in order to enable them to open the biggest distillery in the world in the United States and to enter into business here. Should we drop this legislation and permit these Canadians to do business here with impunity the political repercussions might therefore be obviously very embarrassing.

At the Secretary's request Mr. Green gave figures as to our claims to date against the four principal companies.

The Secretary stated that while he personally was not particularly aroused by these cases he would in his conferences across the street fight for the position we had taken. It was pointed out especially by Mr. Gaston, and the Secretary agreed, that it was too late for us to back down.

The Secretary requested that prior to the conference tomorrow Mr. Graves should confer with Mr. Hickerson of the State Department on the subject of our proposals to see whether the matter could not be ironed out with Mr. Hickerson prior to the conference tomorrow. He also approved clearing the proposals with the Department of Justice.

At the end of the conference Mr. Graves referred to the excellent cooperation which the State Department has given in the matter of a certain ship carrying alcohol from Antwerp which was expected soon to arrive in the United States, and suggested that the Secretary might in the conference tomorrow refer to this excellent cooperation. The Secretary agreed and suggested that a letter might be ready which he might hand to

the State Department on that subject. However, Mr. Graves pointed out that to send such a letter at the present time would be premature and that it might better be delayed until the case had developed more fully.

The Secretary asked how much of these claims arose before and how much after 1930. To this Mr. Green and Mr. Klaus replied that most of the Seagrams claim was after 1930 while most of the Walker claim was before 1930.

At the end Mr. Klaus gave to the Secretary a memorandum giving the general background, especially with regard to the 1930 Export Act; he stated that Mr. Oliphant had suggested that the memorandum be given to the Secretary.

April 10th

I called in Graves to-day and told him that I do not want to leave a stone unturned when the Canadians come down to make a success of this liquor situation and that I am a great deal more interested in being successful than I am in the legislation. I said, "the responsibility is entirely yours as far as the Treasury is concerned". Graves promised and said he understood exactly what I wanted.

April 10, 1936.

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MEMORANDUM OF CONFERENCE BETWEEN SECRETARY MORGENTHAU
AND MR. GRAVES AT MR. MORGENTHAU'S HOME, THURSDAY EVENING,
APRIL 9, AT 6 O'CLOCK.

Mr. Graves reported to the Secretary the results of the afternoon's conferences with the State Department and the Department of Justice with regard to the proposed arrangement for settlement of the Canadian distillery cases, as discussed at the conference in the Secretary's office at 11 o'clock in the morning of the same day.

He advised the Secretary that he had submitted the memorandum outlining the proposed settlement to Mr. Hickerson, who subsequently conferred about the matter with Under Secretary Phillips, Assistant Secretary Moore, and Mr. Hackworth. He said that Mr. Hickerson, at the close of the day, had informed him that, except for two details, the suggested program was apparently satisfactory to the State Department.

The details were: first, the State Department believed that the Treasury should agree, in disclosing the amount of its claims against the companies, to state at least the quantity of liquor involved and the basis for calculation of the claim in each case; and, second, the State Department felt that the proposed requirement that the representatives of the companies be empowered immediately to bind their principals was unnecessarily restrictive. They felt that it would be adequate simply to require ratification of any tentative agreement reached by the Treasury and the representatives of the companies within a reasonable period, say ten days, but not running beyond the "over-all" period of thirty days contemplated by the proposed plan.

Mr. Graves advised the Secretary that the first of these points would necessarily have to be decided by Mr. Oliphant's office, perhaps with the concurrence of the Attorney General. To this Mr. Morgenthau agreed.

As to the second of these points, Mr. Graves indicated that he felt that the suggestion made by the State Department was reasonable in principle and should be acceded to by the Treasury. Mr. Morgenthau likewise agreed to this.

Mr. Graves advised the Secretary that Mr. Frank had spent considerable time at the Department of Justice in conference with Mr. McMahon, Assistant Attorney General in charge of the Criminal Division, and Messrs. Parrish and Kiefer, and that he reported that the Department of Justice, through these officials, had indicated its complete approval of the plan now under consideration.

Mr. Morgenthau raised the question whether it would not be advisable and necessary for the Attorney General to participate in any further conferences had with the State Department, and to share the responsibility for any conclusions which might be reached in such conferences. He strongly indicated his unwillingness to proceed further unless this could be arranged.

Mr. Graves advised him that the Department of Justice was quite as much interested in the proposed legislation and in the ultimate settlement of the cases themselves as the Treasury Department, and stated that he understood that the Attorney General, or someone representing him, was on record as having urged the State Department

to agree to the pending legislation. He said that he felt there would be no difficulty in bringing about the arrangement desired by the Secretary.

At this point, Mr. Morgenthau telephoned Mr. Oliphant and instructed him to contact Attorney General Cummings personally, with a view to securing the approval of the proposed program in principle, and with a view also to arranging that a representative of the Attorney General should be present at further conferences with the State Department. (Pursuant to this instruction, Mr. Oliphant later in the evening--at about 7.00 p.m.--telephoned Attorney General Cummings, who is understood to have advised Mr. Oliphant that Assistant Attorney General McMahon would be instructed to be present at the conference to be held the next day, April 10, at the State Department to consider the proposed program.)

Mr. Morgenthau also mentioned to Mr. Oliphant in his telephone conversation the two points reserved by the State Department as above described, and advised Mr. Oliphant of his views thereon as above indicated.

Mr. Morgenthau advised Mr. Graves that it was his desire that, following the settlement of the Canadian distillery cases, the Department make no further effort to explore violations such as are involved in those cases with respect to any other prospective defendants, but should instead concentrate its entire energies upon a more efficient enforcement of the laws with respect to present-day violations.

my office *12:10*
April 9, 1936.

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BASIS FOR ACCEPTANCE BY THE TREASURY OF THE PROPOSALS
MADE BY SECRETARY HULL AT THE CONFERENCE WITH
SECRETARY MORGENTHAU ON TUESDAY, APRIL 7, REGARDING
THE CANADIAN DISTILLERY CASES.

1. Subject to the conditions proposed by Secretary Hull, the Treasury Department will agree to a delay not exceeding one month in the pending legislation, during which the following steps will be taken with a view to obviating the necessity for the legislation, if possible.
2. The Treasury will receive representatives of the Canadian companies individually and undertake to arrive at a satisfactory settlement of its claims against them, subject to the condition that the Treasury will state the amount, as at present calculated, of its claim against each company but will not be required either to disclose particulars of the claim or to discuss the facts or law supporting it.
3. In the event of the failure of the parties to agree on a settlement, they will undertake to make an arrangement which will bind the companies to submit to the jurisdiction of the United States courts so that the claims may be litigated on their merits, and to provide satisfactory security for the payment of any judgments which may be rendered in favor of the Government.
4. The Canadian companies are to be informed that any persons designated to represent them in conferences with the Treasury must be fully empowered there and then to bind their principals with respect to the points covered above.
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 will be free to proceed with the legislation and the State Department will advise the appropriate Committees of Congress that it has no further objection thereto.

6. Before undertaking to carry out the plan here outlined, the Secretary of State and the Secretary of the Treasury will confer with the Chairman of the Senate Finance Committee with a view to securing the necessary delay of the legislation; and the adoption of the plan will be contingent upon assurances from the Chairman of the Committee that such a delay will not prevent the enactment of the legislation at the present session of Congress should this finally be recommended by the Secretary of the Treasury.

April 10, 1936.

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MEMORANDUM OF THE CONFERENCE HELD IN THE
OFFICE OF THE SECRETARY OF STATE
AT 10:30 A.M., FRIDAY, APRIL 10.

Present:

For the State Department—

Secretary Hull
Under Secretary Phillips
Assistant Secretary Moore
Mr. Hickerson
Mr. Hackworth

For the Treasury Department—

Secretary Morgenthau
Assistant Secretary Taylor
Mr. Cliphant
Mr. Graves

For the Department of Justice—

Assistant Attorney General McMahon,
Mr. Parrish

Mr. Morgenthau presented to Mr. Hull the statement entitled "Basis for Acceptance by the Treasury of the Proposals Made by Secretary Hull at the Conference with Secretary Morgenthau on Tuesday, April 7, Regarding the Canadian Distillery Cases," dated April 9, which Mr. Hull read.

Mr. Hull raised a question as to the wording of the fifth paragraph. He stated that he did not feel free to advise the Senate Finance Committee, in the event of the failure of the negotiations, that the State Department had no objection to the legislation. He referred to the letter addressed to Mr. Whitaker by Judge Moore under date of April 29, 1935, as clearly stating the position of the State Department on the principle of the proposed legislation, and indicated that he would prefer to adhere to that position. This would mean, he said, simply that the State Department would "keep its hands off" the situation and

allow the Department of Justice and the Treasury Department to handle the question before the Senate Finance Committee.

Mr. Morgenthau stated to Secretary Hull his reasons for believing that the Attorney General should participate not only in the present discussion but in the future handling of the cases along the lines proposed in the memorandum of April 9. Mr. McMahon stated that the memorandum met with the full approval of the Department of Justice, and indicated that that Department was fully prepared to participate in the proposed program.

Mr. Morgenthau then stated to Secretary Hull that his desire was to have the memorandum amended so as to indicate throughout that any action taken would be the joint action of the Department of Justice and the Treasury Department rather than the action of the Treasury Department alone.

Judge Moore raised a question with reference to paragraph 2 of the memorandum, pointing out that as this paragraph now stands it would commit the Government merely to state the amount of its "naked" claim. He felt that the Government might well go so far as to disclose also the quantity of liquor upon which its claim was based in any case.

Mr. Oliphant and Mr. McMahon demurred to this suggestion, and pointed out that such a disclosure would be equivalent to a disclosure of the theory of the Government's case and would be likely to compromise the Government not only in the event of litigation, but also in the event it should become necessary to undertake to proceed with the legislation. Mr. Hull and his associates conceded these points, and Mr. Hull

stated that in his opinion this was a matter which clearly should be determined by the Department of Justice and the Treasury Department as they thought advisable.

Mr. Phillips made the suggestion with reference to paragraph 4 that the phrasing was unnecessarily restrictive in that it appeared to compel counsel for the companies to be prepared to bind their principals from the outset of the negotiations by the use of the words "there and then." Mr. Morgenthau stated to Mr. Hull the Department's purpose in suggesting this requirement, which was to prevent any possibility of dilatory tactics on the part of those who should represent the companies. Secretary Hull and Mr. Phillips readily conceded the correctness of Mr. Morgenthau's view, and Mr. Phillips withdrew his suggestion.

Mr. Phillips also raised a question as to the meaning of the words "satisfactory security" in paragraph 3, suggesting that this had proved a stumbling block in connection with earlier conferences with counsel for the companies. Mr. Morgenthau advised Secretary Hull that so far as the Treasury Department was concerned, his purpose would be to impose no conditions upon the companies which Mr. Hull himself would be disposed to regard as unduly harsh, or that the companies could not fairly be expected to meet. Mr. Morgenthau went on to say that the question of "satisfactory security" would, like all other points involved, naturally be subject to discussion and exploration with the individual companies, and would take account of their respective abilities to pay. Mr. Morgenthau again emphasized that his

purpose would be to make, if possible, a just and reasonable settlement with the companies.

Mr. Morgenthau stated that he was optimistic of a favorable outcome of the negotiations with the companies provided the State Department would give "enthusiastic support" to the position taken jointly by the Department of Justice and the Treasury Department in this matter. Mr. Phillips said that he felt, in view of the agreement which had now been reached among the three departments, the State Department could give its "enthusiastic support" to the two negotiating departments. Mr. Hull spoke to the same effect. Mr. Morgenthau finally asked him categorically whether he felt that the State Department could give "enthusiastic support" to the program, and Mr. Hull replied: "You will have our hearty support."

Mr. Hull suggested a minor correction in paragraph 1—the substitution of the word "transmitted" for the word "proposed." He emphasized that the proposals suggested by him at the conference on Tuesday morning were in reality not his proposals but the proposals made by Mr. Wrong.

It was agreed at the end that the Treasury Department, in cooperation with the Department of Justice, would redraft the memorandum of April 9 in the light of the morning's discussion, and transmit the revised memorandum promptly to the State Department. (Note: Mr. Morgenthau subsequently instructed Mr. Graves to withhold transmission of the revised text to the State Department until a clearance could be had from Senator Harrison along the lines of paragraph 6 of the memorandum.)

It was agreed that the Secretary of State, the Secretary of the Treasury, and the Attorney General would each separately notify the Chairman of the Senate Finance Committee of the arrangements made and of the desirability of postponing the further consideration of H. R. 9185.

There was some discussion of the date when the 30-day period mentioned in the memorandum would begin to run. The suggestion was made that it should run from the date of notification by the State Department of the Canadian Government. Mr. Morgenthau, however, suggested that inasmuch as notice to the Canadians will be transmitted this week, it might be well for the time to begin to run on Monday, April 13. This was agreed to.

BASIS FOR ACCEPTANCE BY THE TREASURY DEPARTMENT AND THE
DEPARTMENT OF JUSTICE OF THE PROPOSALS TRANSMITTED BY
SECRETARY HULL AT THE CONFERENCE WITH SECRETARY MORGENTHAU
ON TUESDAY, APRIL 7, REGARDING THE CANADIAN DISTILLERY CASES.

1. Subject to the conditions transmitted by Secretary Hull, the Treasury Department and the Department of Justice will agree to a delay not exceeding one month from April 13 in the pending legislation, during which the following steps will be taken with a view to obviating the necessity for the legislation, if possible.

2. The Treasury Department and the Department of Justice, acting jointly, will receive representatives of the Canadian companies individually and undertake to arrive at a satisfactory settlement of the Government's claims against them, subject to the condition that the two Departments will state the amount, as at present calculated, of the Government's claim against each company but will not be required either to disclose particulars of the claim or to discuss the facts or law supporting it.

3. In the event of the failure of the parties to agree on a settlement, they will undertake to make an arrangement which will bind the companies to submit to the jurisdiction of the United States courts so that the claims may be litigated on their merits, and to provide satisfactory security for the payment of any judgments which may be rendered in favor of the Government.

4. The Canadian companies are to be informed that any persons designated to represent them in conferences with the two Departments

must be fully empowered there and then to bind their principals with respect to the points covered above.

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.

6. Before undertaking to carry out the plan here outlined, the Secretary of State, the Secretary of the Treasury, and the Attorney General, will separately confer with the Chairman of the Senate Finance Committee with a view to securing the necessary delay of the legislation; and the adoption of the plan will be contingent upon assurances from the Chairman of the Committee that such a delay will not prevent the enactment of the legislation at the present session of Congress should this finally be recommended by the Secretary of the Treasury and the Attorney General.

April 10, 1936

The Secretary met today with the following to discuss the subject of countervailing duties: Dr. Viner, Gaston, Haas, Taylor, Oliphant, Johnson from Customs, and Mr. Lochhead.

HM, Jr. said, "All I know about countervailing duties in Germany is that I had a memorandum from Taylor, which I have not read; a report from the State Department, which I have not read; and also one from Haas, so my position up to date has been that I have taken no part in the consideration, for personal reasons, and up to now and while Coolidge was here he handled everything that had to do with Germany and I know nothing about it. I asked Viner to come down particularly because, on the economic side, he has made a study of this thing and I do not know whether he has had time in one day to review the whole thing."

Viner replied, "I have not as yet, but I will stay over until tomorrow if necessary and will then give you a report stating my conclusions." HM, Jr. explained he would not be in the office tomorrow and asked how much pressure was being brought to bear. Oliphant stated that the opinion is that the Treasury is ignoring this situation and Johnson stated that he had had a great deal of correspondence from various industries and his feeling is that the public does not know the difference between dumping and countervailing duties. HM, Jr. inquired if there was any other country that has a comparable situation and Johnson replied, "Hungary and Latvia." HM, Jr. wanted to know if it would be possible, when the Treasury handles the German situation, to handle the other countries at the same time. Johnson explained that was not possible, "because their system is different and their situation has to be handled a little differently."

HM, Jr. then said to Dr. Viner, "After you make your findings, then the Legal Department will have to go into it." This was agreeable to Viner. He asked Dr. Viner to make his report and then let the Legal people take it. They will prepare an answer and HM, Jr. will telephone to Dr. Viner and talk to him about it. He said, "We can settle it over the telephone instead of keeping you here."

HM, Jr. remarked, "Your thought then on this is that since we are dealing with the Secretary's statutory duty, that we take each case on its merit and handle it that way?" He said he wants to treat the German countervailing duties just as we

did Mr. Filene's Twentieth Century Fund case, "on merit alone and permit nothing else to enter into it."

The group left, Taylor, Oliphant and Gaston remaining and being joined by Graves and Klaus who came in to discuss the Canadian liquor cases.

Mr. Morgenthau repeated to the group what he had told Graves at their meeting at his home last night. He had raised the question last night whether it would not be advisable and necessary for the Attorney General to participate in any further conferences which the Treasury would have with the State Department. he had Oliphant call Attorney General Cummings, which he did. Cummings will have Assistant Attorney General McMahon present at the conference today. HM, Jr. said that the Treasury and the Attorney General's Office will make a joint presentation to the State Department.

TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE April 10, 1936.

TO Secretary Morgenthau
FROM Mr. Haas *[Signature]*
Subject: China's February foreign trade.

China's foreign trade for February, 1936, according to information just received in a cablegram, was as follows:

Imports - 63 million yuan
Exports - 46 " "

Imports increased 3 million yuan - about 4 per cent greater than in January, 1936, whereas exports dropped 24 million yuan, or about 35 per cent. The monthly variations of Chinese trade have been much too irregular to indicate whether the sharp decline in exports during February is wholly seasonal. In both 1934 and 1935, February exports also showed sharp declines compared with the previous month. But in both those years the February imports likewise showed sharp declines as compared with the previous month, whereas this year February imports were, as stated above, 4 per cent greater than in January.

U. S. trade with China. Our foreign trade with China for February, 1936, according to U. S. statistics, was as follows:

Exports to China - \$2,426,406
Imports from China - \$9,053,252

Our unfavorable balance of trade with China continues to grow. Our imports from China were about 8 per cent greater than in January, 1936, and our exports to China were about 15 per cent less than in January, 1936.

Compared with February, 1935, our imports from China were more than double last year's, and our exports to China half of last year's.

Foreign Trade of China, 1929 to date

(values in thousands of yuan)

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Month and year	Gross exports		Gross imports	
	Including Manchuria	Excluding Manchuria	Including Manchuria	Excluding Manchuria
1929	1,582,441	1,070,523	1,996,299	1,627,935
1930	1,394,166	944,414	2,069,385	1,747,215
1931	1,416,963	915,169	2,256,276	2,018,406
1932	768,077	569,464	1,655,558	1,541,583
1933	612,293		1,358,978	
1934	535,733		1,038,979	
1935	576,299		924,695	
1933 - Jan.	62,034		103,066	
Feb.	50,311		114,450	
Mar.	45,337		149,258	
Apr.	37,193		148,558	
May	51,576		153,026	
June	50,230		110,971	
July	62,612		104,168	
Aug.	51,404		101,292	
Sept.	48,651		89,841	
Oct.	47,975		95,446	
Nov.	54,239		96,801	
Dec.	50,790		92,103	
1934 - Jan.	50,796		106,214	
Feb.	38,051		83,485	
Mar.	40,211		100,115	
Apr.	41,161		101,724	
May	49,348		95,807	
June	49,184		86,966	
July	44,949		74,478	
Aug.	44,077		75,042	
Sept.	41,814		78,120	
Oct.	42,711		79,745	
Nov.	49,838		84,252	
Dec.	43,595		73,031	
1935 - Jan.	55,305		90,715	
Feb.	41,546		67,428	
Mar.	39,079		97,776	
Apr.	41,595		104,348	
May	40,814		96,689	
June	41,253		91,942	
July	45,975		64,790	
Aug.	45,378		56,459	
Sept.	45,972		54,695	
Oct.	48,516		61,581	
Nov.	60,276		72,737	
Dec.	70,590		65,534	
1936 - Jan.	70,773		61,199	
Feb.	46,358 ^{1/}		63,229	

Treasury Department, Division of Research and Statistics. April 10, 1936

^{1/} Preliminary.

Regraded Unclassified

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China (excluding Manchuria) - Trade with United States - January 1933 to date
(Thousands of yuan)

Gross exports

	1933			1934			1935			1936		
	Total : Exports	Percent : of total	Exports : to U. S.	Total : Exports	Percent : of total	Exports : to U. S.	Total : Exports	Percent : of total	Exports : to U. S.	Total : Exports	Percent : of total	Exports : to U. S.
Total exports	612,292	113,146	18.5	535,735	94,435	17.6	576,299	136,411	23.7			
January	62,034	11,118	17.9	50,796	9,923	19.5	55,305	12,460	22.5	70,773	23,664	33.4
February	50,311	7,744	15.4	38,051	8,385	22.0	41,546	9,667	23.3	46,358	17,358	37.4
March	45,337	8,219	18.1	40,211	11,157	27.7	39,079	11,296	28.9			
April	37,193	6,265	16.8	41,161	7,961	19.3	41,595	10,688	25.7			
May	51,576	10,544	20.4	49,348	8,073	16.4	40,814	10,791	26.4			
June	50,230	11,016	21.9	49,184	7,413	15.1	41,253	10,066	24.4			
July	62,612	15,418	24.6	44,949	6,800	15.1	45,375	10,599	23.1			
August	51,404	11,480	22.3	44,077	7,247	16.4	45,378	8,596	18.9			
September	48,651	8,919	18.3	41,814	5,569	13.3	45,972	10,071	21.9			
October	47,975	7,212	15.0	42,711	6,822	16.0	48,516	11,563	23.8			
November	54,239	8,359	15.4	49,838	7,374	14.8	60,276	12,553	20.8			
December	50,730	6,852	13.5	43,595	7,711	17.7	70,590	18,055	25.6			

Gross imports

	1933			1934			1935			1936		
	Total : Imports	Percent : of total	Imports : from U. S.	Total : Imports	Percent : of total	Imports : from U. S.	Total : Imports	Percent : of total	Imports : from U. S.	Total : Imports	Percent : of total	Imports : from U. S.
Total imports	1,358,980	297,469	21.9	1,038,979	271,733	26.2	924,694	174,930	18.9			
January	103,066	22,162	21.5	106,214	29,835	28.1	90,715	18,537	20.4	61,199	12,361	20.2
February	114,450	28,340	24.8	83,485	34,150	40.9	67,428	14,254	21.1	63,358	17,358	27.4
March	149,258	28,804	19.3	100,115	27,962	27.9	97,776	18,350	18.8			
April	148,558	27,249	18.3	101,724	22,160	21.8	104,348	17,254	16.5			
May	153,026	31,459	20.6	95,807	27,037	28.2	96,689	16,077	16.6			
June	110,971	20,362	18.3	86,966	20,556	23.6	91,942	22,878	24.9			
July	104,168	21,798	20.9	74,478	18,298	24.6	64,790	11,968	18.5			
August	101,292	23,171	22.9	75,042	19,498	26.0	56,459	10,925	19.4			
September	89,841	19,915	22.2	78,120	18,583	23.8	54,695	9,154	16.7			
October	95,446	27,089	28.4	79,745	15,296	19.2	61,581	9,916	16.1			
November	96,801	23,991	24.8	84,252	18,314	21.7	72,737	11,928	16.4			
December	92,103	23,129	25.1	73,031	20,044	27.4	65,534	13,689	20.9			