DIARY

Book 19

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Monday, March 2, 1936.
2-20-36

Press Service
No. 6-92

Secretary of the Treasury Morgenthau is today offering for subscription, at par and accrued interest, through the Federal Reserve banks $650,000,000, or thereabouts, of 12-15-year 2-3/4 percent Treasury bonds of 1948-51, and $600,000,000, or thereabouts, of 5-year 1-1/2 percent Treasury notes of Series A-1941. The holders of 2-7/8 percent Treasury notes of Series C-1936 maturing April 15, 1936, are offered the privilege of exchanging such maturing notes either for the Treasury bonds or the Treasury notes, the exchange to be made par for par with an adjustment of accrued interest as of March 16, 1936, and to the extent such exchange privilege is availed of, the offering of bonds or of notes may be increased.

The 2-3/4 percent Treasury bonds of 1948-51 now offered for cash, and in exchange for Treasury notes maturing April 15, 1936, will be dated March 16, 1936, and will bear interest from that date at the rate of 2-3/4 percent per annum payable semiannually. They will mature March 15, 1951, but may be redeemed at the option of the United States on and after March 15, 1948.

The 1-1/2 percent Treasury notes of Series A-1941, also offered for cash, and in exchange for Treasury notes maturing April 15, 1936, will be dated March 16, 1936, and will bear interest from that date at the rate of 1-1/2 percent per annum payable semiannually. They will mature March 15, 1941, and will not be subject to call for redemption before that date.

The Treasury bonds and the Treasury notes will be accorded the same exemptions from taxation as are accorded other issues of Treasury bonds and Treasury notes, respectively, now outstanding. These provisions are specifically set forth in the official circulars issued today.

The Treasury bonds will be issued in two forms, bearer bonds with interest coupons attached, and bonds registered as to both principal and interest; both forms will be issued in the denominations of $50, $100, $500, $1,000, $5,000, $10,000 and $100,000. The Treasury notes will be issued only in bearer form with coupons attached, in the denominations of $100, $500, $1,000, $5,000, $10,000 and $100,000.

Applications will be received at the Federal Reserve banks and branches, and at the Treasury Department, Washington. Banking institutions generally will handle applications for subscribers, but only the Federal Reserve banks and the Treasury Department are authorized to act as official agencies. With respect to cash subscriptions for either the Treasury bonds or the Treasury notes, applications from incorporated banks and trust companies for either issue for their own account will be received without deposit but will be restricted in each case and for each offering to an amount not exceeding one-half of the combined capital and surplus of the subscribing bank or trust company. Applications from all others must be accompanied, if for more than $5,000, by payment of $5,000 or 5 percent of the amount applied for, whichever is the greater; and, if for $5,000 or less, by payment in full. With respect to exchange subscriptions for either bonds or notes, applications should be accompanied by a like face amount of 2-7/8 percent Treasury notes of Series C-1936 tendered in payment.

Subject to the reservations set forth in the official circulars, cash subscriptions for amounts up to and including $5,000 will be given preferred allotment, cash subscriptions for amounts over $5,000 will be allotted on an equal percentage basis, but not less than the maximum preferred allotment, and exchange subscriptions will be allotted in full.

Payment for any bonds or notes allotted must be made or completed on or before March 16, 1936. If Treasury notes maturing April 15, 1936, are tendered, coupon due April 15, 1936 must be attached to the notes, and accrued

UNITED STATES OF AMERICA

2-3/4 PERCENT TREASURY BONDS OF 1948-51

Dated and bearing interest from March 16, 1936 Due March 15, 1951

REDEEMABLE AT THE OPTION OF THE UNITED STATES AT PAR AND ACCRUED INTEREST ON AND AFTER MARCH 15, 1948

Interest payable March 15 and September 15

1936
Department Circular No. 557

TREASURY DEPARTMENT,
Office of the Secretary,
Washington, March 2, 1936.

Public Debt Service

I. OFFERING OF BONDS

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, approved September 24, 1917, as amended, invites subscriptions, at par and accrued interest, from the people of the United States for 2-3/4 percent bonds of the United States, designated Treasury Bonds of 1948-51. The amount of the offering is $650,000,000, or thereabouts, with the right reserved to the Secretary of the Treasury to increase the offering by an amount sufficient to accept all subscriptions for which Treasury Notes of Series C-1936, maturing April 15, 1936, are tendered in payment and accepted.

II. DESCRIPTION OF BONDS

1. The bonds will be dated March 16, 1936, and will bear interest from that date at the rate of 2-3/4 percent per annum, payable on a semiannual basis on September 15, 1936, and thereafter on March 15 and September 15 in each year until the principal amount becomes payable. They will mature March 15,1951, but may be redeemed at the option of the United States on and after March 15,1948, in whole or in part, at par and accrued interest, on any interest day or days, on 4 months' notice of redemption given in such manner as the Secretary of the Treasury shall prescribe. In case of partial redemption the bonds to be redeemed will be determined by such method as may be prescribed by the Secretary of the Treasury. From

the date of redemption designated in any such notice, interest on the bonds called for redemption shall cease.

2. The bonds shall be exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (a) estate or inheritance taxes, or gift taxes, and (b) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations. The interest on an amount of bonds authorized by the Second Liberty Bond Act, approved September 24, 1917, as amended, the principal of which does not exceed in the aggregate $5,000, owned by any individual, partnership, association, or corporation, shall be exempt from the taxes provided for in clause (b) above.

3. The bonds will be acceptable to secure deposits of public moneys, but will not bear the circulation privilege and will not be entitled to any privilege of conversion.

4. Bearer bonds with interest coupons attached, and bonds registered as to principal and interest, will be issued in denominations of $50, $100, $500, $1,000, $5,000, $10,000 and $100,000. Provision will be made for the interchange of bonds of different denominations and of coupon and registered bonds, and for the transfer of registered bonds, under rules and regulations prescribed by the Secretary of the Treasury.

5. The bonds will be subject to the general regulations of the Treasury Department, now or hereafter prescribed, governing United States bonds.

III. SUBSCRIPTION AND ALLOTMENT

1. Subscriptions will be received at the Federal Reserve Banks and branches and at the Treasury Department, Washington. Banking institutions generally will handle applications for subscribers, but only the Federal Reserve banks and the

Treasury Department are authorized to act as official agencies. Cash subscriptions from incorporated banks and trust companies for their own account will be received without deposit but will be restricted in each case to an amount not exceeding one-half of the combined capital and surplus of the subscribing bank or trust company. Cash subscriptions from all others must be accompanied, if for more than $5,000, by payment of $5,000 or 5 percent of the amount of bonds applied for, whichever is the greater; and, if for $5,000 or less, by payment in full. The Secretary of the Treasury reserves the right to close the books as to any or all subscriptions or classes of subscriptions at any time without notice.

2. The Secretary of the Treasury reserves the right to reject any subscription, in whole or in part, to allot less than the amount of bonds applied for, to make allotments in full upon applications for smaller amounts and to make reduced allotments upon, or to reject, applications for larger amounts, or to adopt any or all of said methods or such other methods of allotment and classification of allotments as shall be deemed by him to be in the public interest; and his action in any or all of these respects shall be final. Subject to these reservations, cash subscriptions for amounts up to and including $5,000 will be given preferred allotment, and cash subscriptions for amounts over $5,000 will be allotted on an equal percentage basis, but not less than the maximum preferred allotment; and subscriptions in payment of which Treasury Notes of Series C-1936 are tendered will be allotted in full. Allotment notices will be sent out promptly upon allotment, and the basis of the allotment will be publicly announced.

IV. PAYMENT

1. Payment at par and accrued interest, if any, for bonds allotted on cash subscriptions must be made or completed on or before March 16, 1936, or on later allotment. In every case where payment is not so completed, the payment with

UNITED STATES OF AMERICA

1-1/2 PERCENT TREASURY NOTES OF SERIES A-1941

Dated and bearing interest from March 16, 1936 Due March 15, 1941

Interest payable March 15 and September 15

1936
Department Circular No. 558

Public Debt Service

TREASURY DEPARTMENT,
Office of the Secretary,
Washington, March 2, 1936

I. OFFERING OF NOTES

1. The Secretary of the Treasury, pursuant to the authority of the Second Liberty Bond Act, approved September 24, 1917, as amended, invites subscriptions, at par and accrued interest, from the people of the United States for 1-1/2 percent notes of the United States, designated Treasury Notes of Series A-1941. The amount of the offering is $600,000,000, or thereabouts, with the right reserved to the Secretary of the Treasury to increase the offering by an amount sufficient to accept all subscriptions for which Treasury Notes of Series C-1936, maturing April 15, 1936, are tendered in payment and accepted.

II. DESCRIPTION OF NOTES

1. The notes will be dated March 16, 1936, and will bear interest from that date at the rate of 1-1/2 percent per annum, payable on a semiannual basis on September 15, 1936, and thereafter on March 15 and September 15 in each year. They will mature March 15, 1941, and will not be subject to call for redemption prior to maturity.

2. The notes shall be exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes, or gift taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority.

3. The notes will be accepted at par during such time and under such rules and regulations as shall be prescribed or approved by the Secretary of the Treasury in payment of income and profits taxes payable at the maturity of the notes.

4. The notes will be acceptable to secure deposits of public moneys, but will not bear the circulation privilege.

5. Bearer notes with interest coupons attached will be issued in denominations of $100, $500, $1,000, $5,000, $10,000 and $100,000. The notes will not be issued in registered form.

III. SUBSCRIPTION AND ALLOTMENT

1. Subscriptions will be received at the Federal Reserve banks and branches and at the Treasury Department, Washington. Banking institutions generally will handle applications for subscribers, but only the Federal Reserve banks and the Treasury Department are authorized to act as official agencies. Cash subscriptions from incorporated banks and trust companies for their own account will be received without deposit but will be restricted in each case to an amount not exceeding one-half of the combined capital and surplus of the subscribing bank or trust company. Cash subscriptions from all others must be accompanied, if for more than $5,000, by payment of $5,000 or 5 percent of the amount of notes applied for, whichever is the greater; and, if for $5,000 or less, by payment in full. The Secretary of the Treasury reserves the right to close the books as to any or all subscriptions or classes of subscriptions at any time without notice,

2. The Secretary of the Treasury reserves the right to reject any subscription, in whole or in part, to allot less than the amount of notes applied for, to make allotments in full upon applications for smaller amounts and to make reduced allotments upon, or to reject, applications for larger amounts,

or to adopt any or all of said methods or such other methods of allotment and classification of allotments as shall be deemed by him to be in the public interest; and his action in any or all of these respects shall be final. Subject to these reservations, cash subscriptions for amounts up to and including $5,000 will be given preferred allotment, and cash subscriptions for amounts over $5,000 will be allotted on an equal percentage basis, but not less than the maximum preferred allotment; and subscriptions in payment of which Treasury Notes of Series C-1936 are tendered will be allotted in full. Allotment notices will be sent out promptly upon allotment, and the basis of the allotment will be publicly announced.

IV. PAYMENT

1. Payment at par and accrued interest, if any, for notes allotted on cash subscriptions must be made or completed on or before March 16, 1936, or on later allotment. In every case where payment is not so completed, the payment with application up to 5 percent of the amount of notes applied for shall, upon declaration made by the Secretary of the Treasury in his discretion, be forfeited to the United States. Any qualified depositary will be permitted to make payment by credit for notes allotted to it for itself and its customers up to any amount for which it shall be qualified in excess of existing deposits, when so notified by the Federal Reserve bank of its district. Treasury Notes of Series C-1936, maturing April 15, 1936, will be accepted at par in payment for any notes subscribed for and allotted and such payment should be made when the subscription is tendered. Coupons dated April 15, 1936, must be attached to the notes when surrendered, and accrued interest from October 15, 1935, to March 16, 1936, ($12.01844 per $1,000), will be paid following acceptance of the notes.

V. GENERAL PROVISIONS

1. As fiscal agents of the United States, Federal Reserve banks are authorized and requested to receive subscriptions, to make allotments on the basis

and up to the amounts indicated by the Secretary of the Treasury to the Federal Reserve banks of the respective districts, to issue allotment notices, to receive payment for notes allotted, to make delivery of notes on full-paid subscriptions allotted, and they may issue interim receipts pending delivery of the definitive notes.

2. The Secretary of the Treasury may at any time, or from time to time, prescribe supplemental or amendatory rules and regulations governing the offering, which will be communicated promptly to the Federal Reserve banks.

HENRY MORGENTHAU, JR.,
Secretary of the Treasury.

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TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Tuesday, March 3, 1936.
3-2-36.

Press Service
No. 6-94

Secretary of the Treasury Morgenthau announced last night that the subscription books for the current offering of 2-3/4 percent Treasury Bonds of 1948-51 and of 1-1/2 percent Treasury Notes of Series A-1941 closed at the close of business Monday, March 2, 1936, for the receipt of cash subscriptions.

Cash subscriptions for either issue placed in the mail before 12 o'clock midnight, Monday, March 2, will be considered as having been entered before the close of the subscription books.

The subscription books for both issues will remain open until further notice for the receipt of subscriptions in payment of which Treasury Notes of Series C-1936, maturing April 15, 1936, are tendered.

Announcement of the amount of cash subscriptions and the bases of allotment will probably be made on Thursday, March 5.

ooOoo

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Wednesday, March 4, 1936.
3/3/36

Press Service
No. 6-95

Secretary of the Treasury Morgenthau announced last night that the subscription books for the current offering of 2-3/4 percent Treasury Bonds of 1948-51 and of 1-1/2 percent Treasury Notes of Series A-1941 will close at the close of business Thursday, March 5, 1936, for the receipt of subscriptions in payment of which Treasury Notes of Series C-1936, maturing April 15, 1936, are tendered. The subscription books for both issues closed on Monday, March 2, for the receipt of cash subscriptions.

Exchange subscriptions for either issue, in payment of which Treasury Notes of Series C-1936 are tendered, if placed in the mail before 12 o'clock midnight Thursday, March 5, will be considered as having been entered before the close of the subscription books.

-ooOoo-

Monday
March 2, 1936

HM,Jr: Hello

W. R. Burgess: Good morning, sir

HM,Jr: Good morning

B: Well, sir, I congratulate you. Your issue was a success.

HM,Jr: Already?

B: Well, from all I've heard.

HM,Jr: Really?

B: I've talked to, oh, seven or eight of the various people I guess, some of the banks -

HM,Jr: Yes

B: - a half a dozen dealers -

HM,Jr: Yes

B: They all say it's going out of the window.

HM,Jr: It's going out of the window?

B: You're going out of the window, yes.

HM,Jr: Well, now, wait a minute, sometimes you throw things out of the window. That's an expression like putting it in the ash can.

B: (Laughter) Sometimes they fly out like birds.

HM,Jr: Oh, I see. They like it?

B: Oh, yes, they all like it, they say it's perfect.

HM,Jr: Yes

B: They say it's perfect.

HM,Jr: - I thought we had a pretty good press. I love the thing in the lead in the story in the Wall Street Journal. Did you see that?

B: No I didn't notice that.

HM,Jr: Well this - I don't know who John P. Broderick is, but you most likely know him. And he starts off his article, 'A whirl-wind over-subscription to the U. S. Treasury offering today and the prospects are that the new securities will command a prompt premium.'

B: That's right, yes.

HM,Jr: Well, from the Wall Street Journal that's quite enthusiastic, isn't it?

B: Well, that's pretty good, yes.

HM,Jr: Yes

B: That's pretty good.

HM,Jr: Well, as you get information will you keep me posted?

B: Yes -

HM,Jr: I see that they're a little slow in opening.

B: What's that?

HM,Jr: I say the opening on the regular board is a little slow today, isn't it?

B: Yes - I've got - I've got openings here -

HM,Jr: Yes

B: - That are just about the same as Saturday's

HM,Jr: Just about the same?

B: The two and three-quarters are the same, they're quoted a hundred and two three six -

HM,Jr: Yes

B: against - / three five on Saturday.

HM,Jr: Yes

B: Saturday's close -

HM,Jr: Well, the notes - we don't get - you get those, the five year, I mean, if there's any change in that?

B: Yes, I haven't got that yet. They're a little slower to get a quote on than the average.

HM,Jr: Yes, Well -

B: but they wanted to close the books.

HM,Jr: Well, you can't close it before tonight anyway, can you?

B: No, not before - no, you can't do it before tonight.

HM,Jr: No, Well -

B: That Texas thing worked out all right so there -

HM,Jr: Well, I haven't heard any complaints. And when I don't hear any complaints I leave it alone.

B; (Laughter) That's right, yes.

HM,Jr: All right, Burgess -

B: Goodbye

HM,Jr: I'll talk to you a little later. I - I - I never, you know, I'm always a little nervous about these things until the end.

B: Well, so am I.

HM,Jr: And I think it's better to be that way.

B: Absolutely, yes. It's better to be safe than sorry.

HM,Jr: Right

B: Yes

HM,Jr: Goodbye

B: Goodbye.

B: Pretty swell -

HM,Jr: Well, I appreciate all your help.

B: Well, that's fine. You're closing the books tonight, aren't you?

HM,Jr: Oh, yes, we'll - we'll put the wire out in ten minutes.

B: Yes, yes

HM,Jr: Now, it's been most helpful and if you notice in the press I've twice acknowledged your help.

B: As for you, we appreciated it.

HM,Jr: No, but you by name.

B: Oh, that's very nice of you.

HM,Jr: If you have noticed it.

B: Yes, I have indeed.

HM,Jr: (Laughter) All right, well you deserved it.

B: (Laughter) Thank you, sir. Glad you feel that way.

HM,Jr: Well, I - everything in the street is O. K., isn't it?

B: Everything is O. K., yes.

HM,Jr: Fine - Well, good night.

B: Good night.

Monday
March 2, 1936

HM,Jr: Hello -

Operator: Mr. Kiplinger is in New York until tomorrow.

HM,Jr: Well, - do they know where he is?

Operator: Just a minute -

HM,Jr: Still rolling all right?

W. R. Burgess: Well, they're coming in nicely. I've got - I've got a report here of subscriptions so far - there's a hundred and sixty-three million of the notes and one hundred and ninety-nine of the bonds. That's very large for this early in the day.

HM,Jr: It is?

B: The only thing that anybody complained about was they think it's too generous.

HM,Jr: Too generous?

B: (Laughter)

HM,Jr: Well -

B: But, I wouldn't worry about that.

HM,Jr: No, well, you and I, we had an upper and a lower on that thing and - and how did I know what friends of mine down here might have said Saturday and Sunday.

B: That's · you were, you Congressional position

HM,Jr: Well, the whole thing, I mean these times are too difficult to -

B: That's right

HM,Jr: Well, what would we have done? Suppose we had gotten out this issue and tried for the hundred and a half and then had some thing -

B: No - I don't - I don't think you could have done that. I think you went as close as was reasonably safe to go.

HM,Jr: And then had something bust over the weekend and -

B: Yes, Well -

HM,Jr: I'd be- I'd much rather be criticized for being a little bit generous -

B: Right

HM,Jr: - than to have go too close, have it fail and then all the explanations in the world wouldn't have gone.

B: Absolutely - absolutely right

HM,Jr: You know?

B: Yes

HM,Jr: If the thing had been a failure why I - everybody would have jumped on me - 'Morgenthau handled the first one and he should have had help and he should have had - if he hadn't let Coolidge go....' you know.

B: Yes, yes -

HM,Jr: What?

B: Well, I'm - I'm perfectly satisfied with it.

HM,Jr: I -

B: I'm not

HM,Jr: I am too, and - that doesn't worry me.

B: No

HM,Jr: At these times a fellow has to take out a little insurance policy and then -

B: Why, of course he does.

HM,Jr: Yes

B: Of course he does.

HM,Jr: Yes - Well, thank you. We'll be talking - what time do you go to lunch?

B: Oh, I lunch right here in the building, I -

HM,Jr: Well, I tell you, I leave about five minutes to one to lunch with the President and will you call me about ten minutes to one?

B: All right, fine.

HM,Jr: Call me about ten minutes of one.

B: Yes, sir

HM,Jr: Thank you.

White House
Draft 3/2/36
Hand to write
Draft "J" checked
by
1. H Oxnard S. C. & Jurney
2 BC Hanna
3. D T Delaney
4. N. W Bell

TO THE CONGRESS OF THE UNITED STATES:

On January third, 1936, in my annual budget message to the Congress I pointed out that without the item for relief the budget was in balance. Since that time an important item of revenue has been eliminated through the decision of the Supreme Court, and an additional annual charge has been placed on the Treasury through the enactment of the Soldiers' Bonus Act.

I said in my budget message: "The many legislative Acts creating the machinery for recovery were all predicated on two interdependent beliefs. First, the measures would immediately cause a great increase in the annual expenditures of the Government - many of these expenditures, however, in the form of loans, which would ultimately return to the Treasury. Second, as a result of the simultaneous attack on the many fronts I have indicated, the receipts of the Government would rise definitely and

sharply during the following few years, while greatly increased expenditure for the purposes stated, coupled with rising values and the stopping of losses would, over a period of years, diminish the need for work relief and thereby reduce Federal expenditures. The increase in revenues would ultimately meet and pass the declining cost of relief. This policy, adopted in the spring of 1933, has been confirmed in actual practice by the Treasury figures of 1934, of 1935, and by the estimates for the fiscal years of 1936 and 1937. There is today no doubt of the fundamental soundness of the policy of 1933. If we proceed along the path we have followed, and with the results attained up to the present time, we shall continue our successful progress during the coming years."

If we are to maintain this clearcut and sound policy, it is incumbent upon us to make good to the Federal Treasury both the loss

of revenue caused by the Court decision and the increase in expenses caused by the Census Act. Adjusted Compensation Payment I emphasize that adherence to consistent policy calls for such action.

To be specific: The Supreme Court decision adversely affected the ~~results in a loss of revenue which would have been collected except for the decision, to~~ budget in an amount of one billion and seventeen million dollars during the fiscal year 1936 and the fiscal year 1937. This figure is arrived at as follows:

Bell

Here is B?

For purposes of clarity I divide ~~this~~ combined deficit into (A) five hundred million dollars new and permanent Treasury income to offset expenditures which will be made annually as a result of the Soil Conservation and Domestic Allotment Act, recently passed and signed by me.

In addition to this item of five hundred million dollars, which we may properly say calls for a permanent tax of at least an equal amount, another item must be considered. The net effect of paying the veterans' bonus in 1936, instead of in 1945, is to add an annual charge of one hundred twenty million dollars a year to the one hundred sixty million dollars already in the budget. This additional sum, recurring annually for ~~nine~~ ten years, which includes the bonds to be issued to the Government Life Insurance Fund will amortize the total cost of the Bonus payments.

We are called upon, therefore, to raise by some form of permanent taxation an annual amount of six hundred twenty million dollars. It may be said, truthfully and correctly, that of this five hundred million dollars represents substitute taxes in place of the old processing taxes, and that one hundred twenty million dollars represents new taxes not hitherto levied.

I leave, of course, to the discretion of the Congress the ~~determination of the form which such taxes should take.~~ formulation of the appropriate bills I invite your

attention, however, to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop "leaks" in present surtaxes.

Extended study of methods of improving present corporate taxes warrants the consideration of changes to provide fairer distribution of the tax load as between corporate profits withheld from stockholders and corporate profits distributed to them as earned. Existing corporate taxes render incorporation of small businesses difficult or impossible and encourage accumulation of surpluses in corporations owned or controlled by taxpayers with large incomes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, as a matter of fundamental equality, should be to seek equality of tax burden on corporate income, whether this income is distributed or withheld from stockholders. As the law now stands, our corporate taxes dip too deeply into the share of corporate earnings going to stockholders who need the disbursement of dividends; while the share

of stockholders who can afford to leave earnings undistributed escapes the surtaxes altogether. This method of evading surtaxes constitutes a problem as old as the income tax law itself. Repeated attempts by the Congress to prevent this form of evasion have not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of inequality it represents and of its serious effect on the Federal revenue. Thus during the year 1936, some $ _____ dollars of corporate profits, which if distributed would have been added to the income of stockholders and their tax, as every personal income is, as matters now stand, is being withheld from stockholders by those in control of these corporations. In one year alone, the Government is thus deprived of revenues amounting to over $ _____ dollars. A tax on corporate profits, which are not distributed as they are earned, would correct this serious inequality. Such a tax would yield approximately the same revenue as would be yielded if the corporate profits were distributed and taxed in the hands of stockholders.

Furthermore, great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the Nation would result. This simplification would be arrived at by the repeal of the present corporate income tax, the capital tax, the related excess profits tax and ~~the present exemption of dividends from the normal tax of individual incomes~~. This would constitute distinct progress in tax reform.

The Treasury Department will be glad to submit figures to the Congress showing that this simplification and removal of inequalities can, without unfairness, be put into practice so as to yield the full amount of six hundred twenty million dollars - the amount I have indicated above as being necessary.

There remains the item of five hundred seventeen million dollars, which results principally in the current 1936 fiscal year from the Supreme Court decision affecting processing taxes. This amount must in some way be restored to the Treasury, even though the process of

restoration might be spread over two years or three years.

In this case also ~~the form of tax or~~ formulating taxes lies wholly in the discretion of the Congress. I venture, however, to call your attention to two suggestions.

The first relates to the redovery of what may well be termed a windfall received by certain taxpayers, who, through court action, were able to have their taxes impounded and later returned to them, ~~because they thought they did not bear their burden~~ A vast number of other taxpayers did not resort to such court action and have paid their taxes to the Government. In the case of the uncollected taxes, by far the greater part was in the main either passed on to consumers or taken out of the price paid producers. The Congress recognized this fact last August and provided in Section 21-B of the Agricultural Adjustment Act that, in the event of the invalidation of the processing taxes, only those processors who had borne the burden of these taxes should be permitted to receive refunds. The return of the impounded funds and failure to pay taxes that were passed on result in

unjust enrichment, contrary to the spirit of that enactment. A tax on the beneficiaries unfairly enriched by the return or nonpayment of this Federal excise ~~can well yield one hundred fifty million dollars.~~ would take a major part of this windfall income for the benefit of the public. 9

This revenue would accrue to the Treasury during the fiscal years 1936 and 1937. Much of

The other suggestion relates to reimbursement of the Treasury by a temporary tax to yield ~~approximately three hundred sixty-seven million dollars.~~ the portion of five hundred and seventeen million dollars not covered by the windfall tax. Such a tax could be spread over two years or three years. An excise on the processing of certain agricultural products is worth considering. By increasing the number of commodities so taxed, by greatly lowering the rates of the old processing tax and by spreading the tax over two or three years, far less burden would be imposed on the ~~producers, processors or consumers~~ producers, consumers or processors than under the old law.

May I once more respectfully invite the attention of the Congress to the simple fact that the credit of the Government is at

its highest; and that with increasing business, sustained prices and improved tax receipts from existing taxes, income and outgo approach each other. To maintain the growing strength of this structure must be our aim.

March 2, 1936
White House 2 P.M.

TAX PROGRAM

A. The loss of revenues during 1936 should be made up by the tax on windfall income and a two-year tax, at ~~one-third~~ 2/5 former rates, on a wider list of agricultural products.

B. All the permanent additional revenue needed can be obtained by merely stopping a leak in present surtaxes. Doing this will, in addition, remove the two major inequalities in our tax system, greatly simplify it for taxpayers and the Government, and constitute the most important tax reform since the adoption of the income tax.

March 2, 1936

White 2. P.M.

Recommendations to Congress by the President

By Article II, section 3 of the Constitution of the United States, the duty is imposed on the President to "from time to time give to the Congress Information of the State of the Union, and recommend to their Consideration such Measures as he shall judge necessary and expedient; * * *".

It is provided in 31 U.S.C. 15 (a) that if estimated receipts are less than estimated expenditures for the ensuing fiscal year, the President shall make recommendations to Congress for new taxes, loans, or other appropriate action to meet the estimated deficiency. This applies to both original and supplemental or deficiency estimates.

THE PRESIDENT'S MESSAGE OF MARCH 3, 1936
PROPOSING ADDITIONAL TAXES

TO THE CONGRESS OF THE UNITED STATES:

On January third, 1936, in my annual budget message to the Congress, I pointed out that without the item for relief the budget was in balance. Since that time an important item of revenue has been eliminated through a decision of the Supreme Court, and an additional annual charge has been placed on the Treasury through the enactment of the Adjusted Compensation Payment Act.

I said in my budget message:

> "* * * the many legislative Acts creating the machinery for recovery were all predicated on two interdependent beliefs. First, the measures would immediately cause a great increase in the annual expenditures of the Government - many of these expenditures, however, in the form of loans which would ultimately return to the Treasury. Second, as a result of the simultaneous attack on the many fronts I have indicated, the receipts of the Government would rise definitely and sharply during the following few years, while greatly increased expenditure for the purposes stated, coupled with rising values and the stopping of losses would, over a period of years, diminish the need for work relief and thereby reduce Federal expenditures. The increase in revenues would ultimately meet and pass the declining cost of relief.
>
> "This policy adopted in the spring of 1933 has been confirmed in actual practice by the Treasury figures of 1934, of 1935, and by the estimates for the fiscal years of 1936 and 1937.
>
> "There is today no doubt of the fundamental soundness of the policy of 1933. If we proceed along the path we have followed and with the results attained up to the present time we shall continue our successful progress during the coming years."

If we are to maintain this clear-cut and sound policy, it is incumbent upon us to make good to the Federal Treasury both the loss of revenue caused by the Supreme Court decision and the increase in expenses caused by the Adjusted Compensation Payment Act. I emphasize that adherence to consistent policy calls for such action.

To be specific: The Supreme Court decision adversely affected the budget in an amount of one billion and seventeen million dollars during the fiscal year 1936 and the fiscal year 1937. This figure is arrived at as follows:

Deficit to date (expenditures chargeable to processing taxes less processing taxes collected) in excess of that contemplated in the 1937 budget ...	$ 281,000,000
Estimated expenditures to be made from supplemental appropriation approved in the Supplemental Appropriation Act, 1936	296,000,000
Estimated expenditures to be made under the Soil Conservation and Domestic Allotment Act	440,000,000
Total additional deficit 1936 and 1937, due to Supreme Court decision and adjusted farm program	$1,017,000,000

For the purposes of clarity, I divide the present total additional revenue needs of the Government into the permanent and the temporary ones.

Permanent Treasury income of five hundred million dollars is required to offset expenditures which will be made annually as a result of the Soil Conservation and Domestic Allotment Act recently enacted by the Congress and approved by me; and an additional sum recurring annually for nine years will be required to amortize the total cost of the Adjusted Compensation Payment Act.

The net effect of paying the Veterans' Bonus in 1936, instead of 1945, is to add an annual charge of one hundred and twenty million dollars a year to the one hundred and sixty million dollars already in the budget.

We are called upon, therefore, to raise by some form of permanent taxation an annual amount of six hundred and twenty million dollars. It may be said, truthfully and correctly, that five hundred million dollars of this amount represents substitute taxes in place of the old processing taxes, and that only one hundred and twenty million dollars represents new taxes not hitherto levied.

I leave, of course, to the discretion of the Congress the formulation of the appropriate taxes for the needed permanent revenue. I invite your attention, however, to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop "leaks" in present surtaxes.

Extended study of methods of improving present taxes on income from business warrants the consideration of changes to provide a fairer distribution of the tax load among all the beneficial owners of business profits whether derived from unincorporated enterprises or from incorporated businesses and whether distributed to the real owners as earned or withheld from them. The existing difference between corporate taxes and those imposed on owners of unincorporated businesses renders incorporation of small businesses difficult or impossible.

The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, 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 escapes current surtaxes altogether.

This method of evading existing surtaxes constitutes a problem as old as the income tax law itself. Repeated attempts by the Congress to prevent this form of evasion have not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over four and one-half billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand, it will be withheld from stockholders by those in control of these corporations. In one year alone, the Government will be deprived of revenues amounting to over one billion three hundred million dollars.

A proper tax on corporate income (including dividends from other corporations), which is not distributed as earned, would correct the serious two-fold inequality in our taxes on business profits if accompanied by a repeal of the present corporate income tax, the capital stock tax, the related excess profits tax and the present exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income should be graduated and so fixed as to yield approximately the same revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders.

Such a revision of our corporate taxes would effect great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the nation. It would constitute distinct progress in tax reform.

The Treasury Department will be glad to submit its estimates to the Congress showing that this simplification and removal of inequalities can, without unfairness, be put into practice so as to yield the full amount of six hundred and twenty million dollars - the amount I have indicated above as being necessary.

Turning to the temporary revenue needs of the Government, there is the item of five hundred and seventeen million dollars, which affects principally the current fiscal year. This amount must in some way be restored to the Treasury, even though the process of restoration might be spread over two years or three years.

In this case also the formulation of taxes lies wholly in the discretion of the Congress. I venture, however, to call your attention to two suggestions.

The first relates to the taxation of what may well be termed a windfall received by certain taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them or which otherwise have remained unpaid. In unequal position is that vast number of other taxpayers who did not resort to such court action and have paid their taxes to the Government. By far the greater part of the processing taxes was in the main either passed on to consumers or taken out of the price paid producers. The Congress recognized this fact last August and provided in Section 21 (d) of the Agricultural Adjustment Act that, in the event of the invalidation of the processing taxes, only those processors who had borne the burden of these taxes should be permitted to receive refunds. The return of the impounded funds and failure to pay taxes that were passed on result in unjust enrichment, contrary to the spirit of that enactment. A tax on the beneficiaries unfairly enriched by the return or nonpayment of this Federal excise would take a major part of this windfall income for the benefit of the public. Much of this revenue would accrue to the Treasury during the fiscal years 1936 and 1937.

The other suggestion relates to a temporary tax to yield the portion of five hundred and seventeen million dollars not covered by the windfall tax. Such a tax could be spread over two years or three years. An excise on the processing of certain agricultural products is worth considering. By increasing the number of commodities so taxed, by greatly lowering the rates of the old processing tax and by spreading the tax over two or three years, only a relatively light burden would be imposed on the producers, consumers or processors.

FRANKLIN D. ROOSEVELT

The White House,

March 3, 1936.

Tuesday
March 3, 1936

HM,Jr: Hello

John Garner: Hello

HM,Jr: Henry Morgenthau, Junior -

G: Yes, Henry

HM,Jr: How are you?

G: Oh, I've just had two teeth pulled out, about an hour ago -

HM,Jr: My gosh!

G: And my God! You know I don't feel so good.

HM,Jr: Not so good?

G: Yes

HM,Jr: - Hello?

G: Yes

HM,Jr: This is what I'm calling up about -

G: All right

HM,Jr: In confidence, - it isn't very confidential but I'm going to say it is -

G: All right

HM,Jr: There will be a tax message coming up I guess at noon, see?

G: Yes

HM,Jr: Now, if Pat Harrison or anybody else would like people from the Treasury to come up immediately after tax message and explain what the President has in mind we'd be delighted to come up, see?

G: Yes

HM,Jr: Hello?

G: Yes, all right, I'll tell him.

HM,Jr: Now, will you tell Pat if he wants to see us any time from two o'clock on -

G: Today?

HM,Jr: Today -

G: He can do it.

HM,Jr: We'd be available and it would most likely - well, we - I'll send up -

G: No, I'll tell Pat if he wants to see you today why you'll be at his -

HM,Jr: From two - any time after two o'clock.

G: After two o'clock? I'll tell -

HM,Jr: And I think, if it will be agreeable to you, I'd like to have you there.

G: All right, I'll do any damned thing I can. I tell you, I've been laying down this morning. The Doctor told me that I couldn't stand too much of this shock.

HM,Jr: Yes

G: Say, Henry -

HM,Jr: Yes, sir

G: I wish you'd see Gibson - you remember a long time ago we talked about that border down there - Border Patrol?

HM,Jr: Yes

G: And the President gave instructions to cancel that damn stuff - ?

HM,Jr: Yes

G: They never did do it and now they're firing four or five fellows there that's the best there is or ever been on the Border.

HM,Jr: Yes

G: And it's a God damned shame, old top, to have to give up those kind of men. One man in particular that I have known since he was a boy -

HM,Jr: Well, that's in the Labor Department, isn't it?

G: No, no, that's just Border Patrol. God damn it, I'm disgusted.

HM,Jr: Border Patrol?

G: Yes - not Border Patrol, but the Customs -

HM,Jr: Oh -

G: - Inspectors, you know?

HM,Jr: Oh, yes

G: The fellows that ride on horse-back and ride up and down that river for twelve hundred miles.

HM,Jr: Yes

G: Now, there's one fellow down there that I happen to know and he went broker here three - two - three years ago -

HM,Jr: Yes

G: And he

HM,Jr: Yes

G: This fellow is about thirty-eight or forty years old.

HM,Jr: Yes

G: He's the best cow man in Texas.

HM,Jr: Yes

G: Now this Collector of Customs has lost lots of cattle down there and they have to estimate their value, you know?

HM,Jr: Yes

G: - their weight. This fellow is uncanny in guessing their weight. His accuracy is something phenomenal.

HM,Jr: Yes

G: And by God now he's going to have to fire him because he didn't have two years service in the army or some other damn thing, I don't know what it is!

HM,Jr: Well, now -

G: It just makes me sick.

HM,Jr: Listen, when I come up there,you have a little memo for me and give it to me and I'll be delighted to look into it, will you?

G: All right

HM,Jr: You have somebody write me out a little memo and you hand it to me -

G: All right

HM,Jr: And I'll take it when I come up.

G: Yes, I want you to tell Gibbons or Dow or somebody that they ought to have some sense and a good

HM,Jr: O. K. Well, now -

G: All right

HM,Jr: When I come up -

G: Yes

HM,Jr: You give it to me -

G: I'll be glad to see you any time.

HM,Jr: Well, I'm not - I'm going to sit tight until I hear from you.

G: Well, I say - you're going to sit tight until you hear from Pat?

HM,Jr: Yes, but I'll see you on that other matter anyway.

G: All right

HM,Jr: O. K.

G: All right, Goodbye

Joseph W. Byrns

Tuesday
March 3, 1936

HM,Jr: Hello -

Speaker Byrns: Hello, Mr. Secretary -

HM,Jr: Hello, Mr. Speaker -

B: Yes, sir

HM,Jr: How are you?

B: Fine

HM,Jr: Mr. Speaker, I'm going to tell you, I guess there's no great secret, but some time around noon the President's Tax Message is going to come up -

B: I just got word. It will be up about twelve o'clock.

HM,Jr: Now, Mr. Speaker, if you and Doughton would care to have me and some of our Treasury people to come up there, say any time after two o'clock, and sit down and explain it or answer any questions, why we'd be delighted to.

B: Well, that'll satisfy Bob Doughton and I'd like to have you do it. Would you mind calling him and telling him so?

HM,Jr: Well -

B: - or have you done it?

HM,Jr: I - oh, no - no, no -

B: Well, you call Bob Doughton and tell him. I'd rather you'd tell him than for me to tell him.

HM,Jr: You think it's better?

B: Of course I can carry the message for you, but - you call Bob.

HM,Jr: You think that I better call Bob direct?

B: Yes, I'd call Bob. You can tell him you talked to me about it also, but - I'd call Bob.

HM,Jr: Well now, when we come up do you want to see us or will we just see Bob?

B: Well I expect I'll be in the Chair - this is private claims and -

HM,Jr: I see.

B: I'll have to stick around the House pretty close.

HM,Jr: Well then, I'll call him up and talk to him.

B: All right.

HM,Jr: Well, I'll take your advice.

B: All right.

HM,Jr: Thank you.

Tuesday
March 3, 1936

HM,Jr: Hello -

Rep. Doughton: All right, Mr. Secretary.

HM,Jr: How are you?

D: Very fine, thank you, how are you?

HM,Jr: Fine, how are things down home?

D: Well, all right
everything is all right down there.

HM,Jr: Now, I was just talking to the Speaker and I was saying in confidence that the President's Tax Message was coming up at noon -

D: That's fine.

HM,Jr: And if around - any time after two o'clock that you and any of your little Cabinet would care to see me and some of the Treasury officials why we'd be delighted to come up. I mean, just privately, you know and sit down and just go over what the President had in mind, you know.

D: Yes - I tell you what I had in mind -

HM,Jr: Yes

D: And I'll see how we - or how

HM,Jr: Yes

D: I served notice on - anticipating this message today -

HM,Jr: Yes

D: I wanted to get right to work without any delay -

HM,Jr: Yes

D: But to take the Committee into my confidence from the start -

HM,Jr: Yes

D: I had the members of the Committee - full Committee, all the members, Republicans and Democrats called yesterday afternoon -

HM,Jr: Oh, yes

D: And advised that soon after the President's Message today, I'd call them together here in the House in the Committee Room for a little Conference as to procedure.

HM,Jr: Yes

D: Now we began prophesying it would be a little and I thought I'd talk it over with them all together.

HM,Jr: Fine

D: I want to try to remove this as far as I can.

HM,Jr: Fine

D: I thought maybe we could put as much of the responsibility on the Republicans as I could.

HM,Jr: That's right.

D: Now if you I had called that conf. or after/you'd better come.

HM,Jr: Well, I'll abide entirely by your good judgment.

D: (Laughter) Well, I'll call you back on that.

HM,Jr: Anything you say, I'm ready.

D: You want to be ready and then I'll call you back as soon as we'd like for you to come up?

HM,Jr: Yes, I'll drop everthing and come when you ask me.

D: Thank you, so much.

HM,Jr: O. K.

D: Goodbye.

Brady

WASHINGTON POST

3/3

The Fiscal Crisis.

Announcement of a forthcoming Treasury loan, which will raise the Federal debt well above $31,000,000,000, coincides with publication of A. F. of L. estimates indicating a severe setback in employment gains. The national debt is now not only at a record high figure but it has almost doubled during the past five years and is about $10,000,000,000 greater than when the present Administration took office.

This extraordinarily rapid increase would not be so disturbing if the Government had succeeded in making satisfactory headway against unemployment by its spending policies. But even allowing for probable inaccuracies in the A. F. of L. estimates, the number of idle workers is known to be appallingly large. Moreover, the January rise in unemployment is said to be more than seasonal, making the prospect of a substantial reduction in the numbers on relief rolls seem increasingly remote.

The first conclusion to be drawn from contemplation of these very unpleasant facts is that the Federal Government must be prepared to carry a heavy relief load for a long time to come. The cost could be much reduced, however, without imposing undue hardships upon the unemployed, by shifting responsibility for the administration of relief to State and local governments and forcing the political units to contribute to expenses to the limit of their ability. Such reforms, together with more abundant revenues from existing taxes, would go a long way toward eliminating future budgetary deficits, though still not far enough.

Those organized groups who are now clamoring for sound fiscal policies, while objecting violently to any suggestions for new taxation, are prone to underrate the difficulties in the way of retrenchment, and to overrate the automatic gains in revenue. Those who are genuinely eager to see an end to demoralizing fiscal disorganization realize that a combination of new taxes and reduced expenditures is required to reach that objective.

The record speaks for itself. When President Roosevelt penned his last budget message, the estimated deficit for 1937—omitting additional relief expenditures—was in excess of $1,000,000,000. Since then, the revenue from processing taxes has been lost and veteran bonus payments have been voted. As a result, between $2,000,000,000 and $3,000,000,000 has been added to the unbudgeted deficit. Yet Congress is still toying with grandiose plans for rural electrification, housing and other lavish projects. It is time to realize that extravagance during the past three years will prevent large-scale expenditures for social legislation in the near future.

If there were any assurance that the relief outlays would be cut to the irreducible minimum, and that Congress would resist further raids by privileged groups upon the Treasury, the voting of new taxes would not seem so imperative. But new taxes are also important as a means of creating sentiment in favor of economy. Direct taxes upon individual incomes, especially in the middle and lower brackets, would emphasize the folly of our spending policies and make the people realize that they are the ones who in the long run pay for governmental extravagance.

The tax program tentatively outlined by President Roosevelt is far too modest. Most of the proposed increases in revenues would merely offset the lost returns from processing taxes, leaving other unbudgeted expenditures (in addition to the relief outlays) to be financed by loans. In order to make any real headway toward the goal of a balanced budget the President must take the initative conferred upon him by the budget act and present Congress with a definite tax program.

If the President's tax message contains strongly worded, specific recommendations for raising revenue, Congress will find it difficult to evade responsibility for improving the budgetary position. If he is content to offer advice of a general sort, the deficit will doubtless continue to increase, in the vague hope that something may turn up to avert disaster.

March 3, 1936

At the group meeting this morning, HM,Jr. brought up for discussion the following excerpts from Upham's memo to him of March 2:

> "In December Mr. Coolidge told the Federal Reserve Banks (through the Board of Governors) that if they would consent to the discontinuance of federal reserve notes bearing the notation that they are redeemable in gold, he would 'submit to the members of the appropriate committees of Congress the question of making at its next session, an appropriation' with which to defray the cost of printing new notes, shipping the new notes out, and returning and destroying the old notes.
>
> "The Board of Governors agreed to start paying out from the new stock of federal reserve notes which are not redeemable in gold, with the understanding that if Congress does not act at this session, they will revert to paying out notes of the old type."

HM,Jr. appointed Mr. Oliphant, Mr. Upham and Mr. Bell as a committee to study this and to decide what the Treasury should do. He said he wants to make an honest effort to help them if we can.

Yesterday when Mr. McReynolds mentioned an increase in salary for Mr. Sloan because of a promise made to Sloan by Coolidge that after six months' service in the Treasury he would receive an increase, HM,Jr. remarked that he thought Bryan's salary was too much and asked Mr. McReynolds and Mr. Taylor to talk over the two salaries and report on it at today's meeting.

Pursuant to that instruction, McReynolds today suggested that inasmuch as Bryan is a publicity man that he should be put back in Gaston's office and let Sloan be in complete charge of and responsible for baby bond sales. HM,Jr. disagreed and told Mr. Taylor he wants publicity on baby bonds to be a separate activity entirely apart from Gaston's organization. He wants to build up a separate sales organization for baby bonds and included in that set-up he wants a publicity department. When publicity

problems are ready for final decision, Mr. Taylor and Mr. Gaston would then pass on them, but Mr. Gaston would not be consulted until they are ready for final decision. HM,Jr. also said that if Bryan is not the one for this job, then the men should have the courage to fire him but he is leaving it entirely to them to decide. He suggested discussion of this at the 9:30 meeting tomorrow.

When the meeting adjourned, Mr. Morgenthau asked Oliphant and Gaston to remain, to discuss publicity in connection with the President's tax message. Gaston was of the opinion that since the message is very complicated that there should be follow-up publicity on it after it is sent to Congress and some explanatory work done. HM,Jr. thought the message should be explained to Steve Early first and then someone from the Treasury ought to see the Speaker. Mr. Oliphant suggested that Helvering should talk to the Speaker and Mr. Morgenthau asked Oliphant to accompany Helvering when he called on Mr. Byrnes. HM,Jr. also thought that Doughton and Pat Harrison ought to get an explanation, and that a story ought to be sent to Charlie Michaelson for use in his publicity letter. The Secretary told the men that in his opinion if the publicity in connection with the tax message were handled carefully, it would be one of the biggest things of the year for the President.

HM,Jr. called McIntyre and asked that he arrange an appointment for him and Mr. Grimm to see the President on housing, and another appointment for HM,Jr. to see the President with Bell on the timing of the bonus.

March 3d

Meeting held in Secretary Morgenthau's office this morning at 10:15 on Unemployment

Miss Lonigan: (speaking from lists of figures) That is the same as 4 million 368 - heads of families. Of this half a million don't want work because they are sick of working.

Mr. Morgenthau: Who says they don't want work?

Miss Lonigan: These figures are all from TERA records.

Miss Roche: The ones that didn't want to work were nil. The number that are applying for work is 3 million 9. Of this 2 million 6 have been put to work.

Miss Lonigan: Other people put to work not from relief rolls. 1 million 2 awaiting assignment. States are worrying about them. These may be left one way or another. According to statistics that still is a state burden. There are 3 million 6 employed on works program in January, leaving 985 thousand.

Miss Roche: This 985 is not from relief - that includes CCC boys.

Miss Lonigan: I do not know.

Miss Roche: Well it does.

Mr. Morgenthau: From the 985 should be deducted the CCC. Let's say it does - the 985 breakdown - it is very important.

Miss Lonigan: No implications in any of those figures.

Mr. Morgenthau: I don't understand the 999.

Miss Lonigan: The top line - 4 million 468 is certifications. Members of families were not employable. Workers would estimate the state and local burden of about 1 million.

Mr. Morgenthau: 1 million?

Miss Lonigan: Yes.

Mr. Morgenthau: Non-employable 1 million?

Miss Lonigan: Yes.

Miss Lonigan: In addition to the state and local burden is this group of certified people applying for work - 1 million 20, making total for states and local 4 million 2.

Mr. Morgenthau: That 448 thousand might not come out of the 999?

Miss Lonigan: No it would be added because that 448 has been certified. 999 has been left over. They should never have been certified.

Mr. Bell: You don't think some of the people in the 1 million 294 would come out of the 999 - doubling up there?

Miss Lonigan: Yes - anybody who was employable.

Miss Lonigan: This was made out of figures that never were fitted in the first place.

Mr. Morgenthau: Give me some figure that has a base.

Miss Lonigan: A base? 468,773. Every figure in that ---

Mr. Morgenthau: I don't care. I want something so that when I meet with Hopkins. I want something that he will admit is the base.

Miss Lonigan: Everything in the first half - 4368.

Miss Roche: The one they usually take is 3612.

Miss Lonigan: That is the total employed for January - 3612.

Mr. Morgenthau: I don't want to start an argument. I have to take their figures. Give me something. I just want two figures.

Mr. Morgenthau: How many of the 4368 at work?

Miss Lonigan: Out of those is the 2 million 623. All out of the certifications.

Mr. Morgenthau: All right.

Miss Lonigan: Awaiting assignment is 214.

Mr. Morgenthau: 4368 - employed on projects is 262.

Mr. Bell: No those are relief workers.

Mr. Morgenthau: Then the 262 plus 985 is your 3612.

Miss Lonigan: This 1 million or whatever it is - there might be minor changes in it that is bothering the states.

Mr. Morgenthau: I don't want a social workers war as to whose figures are right. I don't want to get into that argument. I want to take the figures he is using. I can't investigate at this stage whether his figures are right or wrong. He has 4 million 6 certified - 3 million 6 at work.

Miss Lonigan: There are 1 million certified looking for work which you don't want to consider. They are looking for work - that is 1,420,963.

Mr. Bell: One is workers at work from relief rolls - 2626 taken from the certified list of relief people. The other is 1 million 294 from the certified list which are awaiting assignment.

Miss Lonigan: Over and above the 1/2 million there are 1 million certified who are not at work and want work.

Mr. Bell: Now there are 985 thousand working on relief projects which did not come from relief rolls.

Mr. Morgenthau: The thing that stands out to me as the most significant is 1 million and a half people who want work and are not able to get it. Taking your figure with the breakdown there are almost 1 million people who are not on the relief roll.

Miss Roche: In my own state we had 32,000 certified - 46,000 that worked.

Miss Lonigan: They should be in the 448 up in the second line and added to that 985.

Mr. Morgenthau: Could you see Corrington Gill this afternoon so you can agree on it and put the figures on my desk at 10:15 tomorrow morning.

Miss Lonigan: We can just see what happens. There might be a difference in ---

Mr. Morgenthau: I mean the 985 so that the figure would start off "Number of People at Work" - "Number of People Seeking Work". Have it in an orderly way. I will give this back to you. (Handed reports back to Miss Lonigan)

Miss Lonigan: The other figure you might want to see at the bottom. You get a total of 5 million 9 - 6 million altogether on state and local - increase of 1/2 million over January, 1935. Maybe you didn't want it in the picture.

Mr. Morgenthau: If you don't mind my saying so it is not orderly. I want it boiled down.

Mr. Bell: You get double employment by the government - two elements - relief workers and non-relief workers. It seems to me those are the figures you want.

Mr. Morgenthau: About 1 million and a quarter who would like to have work.

Mr. Morgenthau: (to Mr. Bell) Could you do this- put somebody who is a bookkeeper to work with Miss Lonigan this afternoon - Bartelt or somebody.

Mr. Bell: Yes.

Miss Lonigan: I do not see a very definitely chosen order from their figures.

Mr. Morgenthau: Could you go over and see Corrington Gill and tell him I want one sheet at 10:15 tomorrow which will give us the thing so that you both agree.

Miss Lonigan: I have some material in charts which you may or may not want to look at. This shows New York State only - families aided. Add WPA, upstate TERA and you get a total receiving aid of 669,000. The contrast is that February - Relief rolls are 100,000 higher in New York State than they were a year ago.

Miss Lonigan: (showing another chart) This is New York City Mr. Secretary. We are spending 7 million a month more on all types of public relief than we spent a year ago which was a record. December, 1935 they had 468 thousand families. A year ago they had 365 thousand families - increase of 100,000 families receiving aid.

Miss Lonigan: These charts - the middle of the year - the last year 1935 - there are three years here 33, 34 and 35 --

Mr. Morgenthau: This is total?

Miss Lonigan: This is total - New York City. First half of '35 was a record - higher than anything else. Second half of '35 you can see for yourself. If you want them put together that is the way they look.

Mr. Morgenthau: Mr. Haas told me you said this job could be done for the next 12 months for a billion dollars.

Miss Lonigan: There are questions of policy. You tell me the policy and I can put it together.

Miss Lonigan: Here is another series of charts. In this series they just dropped out the whole WPA expenditures. I will now put them in. Whole thing has been allowed to go on now for six months without the largest pieces in it. When I put the WPA in it that will go way above the maximum. Last year we thought we had a record and they are way ahead of last year.

Mr. Morgenthau: You don't take that out of the Treasury?

Miss Lonigan: That is the million 2?

Mr. Morgenthau: The money that is being spent.

Miss Lonigan: This is not federal - this is state and federal.

Mr. Morgenthau: Total expenditures out of the 4 billion 8 does not check.

Miss Lonigan: It is being carried by the states and cities.

Mr. Bell: You are including both state and city?

Miss Lonigan: Yes.

Mr. Morgenthau: What is it running?

Mr. Bell: 2 million 275 a month. Our budget contemplated a larger expenditure than last year by about 300 million but I don't think it will reach that now.

Mr. Morgenthau to Miss Lonigan: I mean you make that about as hard as you can for me. Don't show me detached pieces. Haven't you got something instead of giving me little pieces?

Miss Lonigan: What I was trying to point out was that the works program put 2 million 500 thousand to work and the 7 million 2 ---

Mr. Morgenthau: You have me so confused. How can I arrive at a figure?

Miss Lonigan: Multiply it by $50.00 a month.

Mr. Morgenthau: But don't tell me what to do. Have you got something there?

Miss Lonigan: You cut Works Program from 3 million 5 to 2 million and save expenditures on the Works Program and transfer that money to the grant to take care of 6 million families. Set up on a $1.00 per capita basis.

Mr. Morgenthau: Have you got it written out.

Miss Lonigan: No - I didn't try to.

Mr. Morgenthau: Can you have it by 10:15 tomorrow?

Miss Lonigan: Yes.

Mr. Morgenthau: If you do that how much does that take?

Miss Lonigan: That runs up. If you take 2 million people at $50. a month it runs up to 100 million a month. Then take the 2 million families - this is very tentative - not on the Works Program - have the federal government contribute half of that and you run a monthly expenditure of 20 million a month - total 120 million a month. The federal rolls have been permitted to swell. You used to have a decline amounting to 5%. We are taking on cases and not taking any off. Expenses have to go up or you have to make a shift. Works Program is spending more money and taking care of fewer people.

Mr. Morgenthau: Let me have your convictions after studying this thing for months, what you think ought to be done beginning July 1st.

Miss Lonigan: Expenses run two or three times higher in western states. Cut all western states 10% if you are willing to hold Works Progress down. Cut out entire farmers and eliminate people that are at present employed. They have people in New York City on their program. They have sick people, lame people, etc.

Mr. Morgenthau: Here is the way I see the problem. This is where I want help. Let's take the figure - what can the President do for 12 months with a billion and a half - what can he do with one billion and three quarters.

Miss Lonigan: With a billion and a half he would ---

Mr. Morgenthau: I don't want it now. One billion and a half, 1 billion and a quarter - one billion. You get me so upset with all these - throwing small pieces at me. It does not help me to know there are 100,000 more unemployed in New York. The President made a statement that the relief would not cost more than 1 billion 276. Give me suggestions as to what he can do with one billion and a half, one billion and a quarter - one billion. The heading of the thing will be "one billion and a half" - he can take care of so many people and so many will not be taken care of; one billion and a quarter - he can take care of so many people in the following method and so many not taken care of.

Miss Lonigan: Then you come in to the question of policy. Next you can go to the dole and cut money down. If you start grants you will build up tremendous pressure from the states so you open up a terrific pressure group for more money than last year.

Mr. Morgenthau: But in order to clear it up for me?

Miss Roche: By this you can do this and that.

Mr. Morgenthau: The President chided me and called me down when I went up on the hill. He said I never thought I used more than one million and a half. He is using a smaller figure. How many human beings can we give a decent job to and how many human beings will be out in the cold? In order to take care of everyone maybe they will have to adjust the program and give them different kind of work. Take for example that her figure is right and CCC is not included, that there are 1 million now at work who are to come off the relief rolls. I would hear that they went off from that relief with the possible exception of 10% which is sick. If Ickes, the War Department, the Navy and the Treasury are giving work to people who are on relief drop them first and make room for the people who need it. Is that sense or isn't it?

Miss Roche: Yes I think it is.

Mr. Morgenthau: When the President buys 25 million of vacant land he does not put anyone to work. We must get along without these luxuries. Have I helped you to give me what I want?

Miss Lonigan: Yes I think so. I can make them short.

Mr. Morgenthau: Let somebody else challenge them. Let Gill say this is ridiculous. We won't argue - you say it is ridiculous and Miss Lonigan says it is so. After the meeting we will meet to see who is right. I haven't time any more. When Haas tells me there is 4½ million dollars undistributed I say George are you sure it is right. He says I will stake my reputation on it. I say, all right I will take your word. Let Hopkins' organization tear it apart. If it needs a footnote to explain what your conclusions are put a footnote.

Mr. Taylor: I don't know that they properly go into this group. Why not eliminate complications which appear in the 4 billion 4 and so on. You get several new problems in there. If you want it to look constitutional have them work on soil erosion among other things. It seemed to me that this might be the occasion for eliminating a great deal of conflictions and duplications.

Mr. Bell: Well that brings up this whole land problem.

Mr. Taylor: Soil erosion is in four different places now.

Miss Lonigan: That is the whole difficulty.

Mr. Taylor: There are certain things which have not been talked of at all. Then you have this reclamation thing which is contrary to your soil erosion.

Mr. Bell: Senator Walsh said he did not want large awards for land utilization but he was taking it out of production.

Mr. Morgenthau: Walsh has told me he asked Ickes how many acres he would bring into production and never got the figures.

Mr. Bell: All of your CCC and other organizations - Parks and Forests - that are doing soil erosion is being done under the immediate supervision of the soil erosion conservation.

Mr. Morgenthau: Where is that located?

Mr. Bell: Over in Agriculture.

Mr. Bell: They are using the CCC boys in the Park Service and Forest Service.

Mr. Morgenthau: They have 5 million dollars to do this.

Mr. Morgenthau to Miss Lonigan: Let's do it this way. You get this ready and bring it in to Miss Roche and let her go over it with you. I have to do this thing first. We have so much cloth. Let's see what we can get out of it. Supporting data is up to Corrington Gill.

March 4, 1936

The Secretary today held his first conference on the relief program preliminary to reporting to the President. Present were Harry Hopkins, Corrington Gill, Mr. Bell, Mr. Taylor, Mr. Gaston, Miss Roche and Miss Lonigan.

Harry Hopkins suggested the meeting begin by having Mr. Gill report the present status of the Works Program. Gill stated that the problem during the past year has been to get localities to take care of the unemployables. He estimated their number to be 4,200,000. He expected that the Social Security Board, next year, will take care of a great deal of the problem with the result that for the next fiscal year employment under the Works Program should be given to 3,500,000 people, not including CCC, enrollment in which is being curtailed.

Gill estimated that the average cost per person per month under PWA would be $70 per month, or $840 per year, per person, contrasted with an estimated cost of $4500 per year if handled through PWA.

HM,Jr. called attention to two sets of figures furnished him by Miss Lonigan which showed (1) that at present there are just under 1,000,000 people working on the various projects out of the $4 billion 8 who do not come off relief rolls, and (2) that there are, in round figures, about 1,250,000 people on the certified relief rolls who want work and were not taken care of. Gill's comment was that the first figure was incorrect; the second one, correct. Hopkins thought the second figure was high and explained that certification depends on "who tells you they are certified." The Secretary's comment was that the whole thing was confusing to him and said what he wanted to get from Gill -- he could work on it tonight and have it ready tomorrow -- was a sort of inventory of what the situation is today; that is, the unemployment figure, both Federal and State.

At this point Gill explained that on January 11 there were 3,612,000 people working. Of that number, 3,326,000 were from relief rolls and 245,000 were non-relief. He said the status of the balance of 41,000 was unknown. It should be noted here that earlier in this meeting he stated that

provision should be made next year for 3,500,000, which amounts to a reduction of only 112,000 persons. Answering the Secretary's inquiry as to how many on top of the 3,612,000 are State and County charges which the Federal Government is not taking care of, Mr. Gill replied that there are 1½ million people who want work and are not getting it.

Asked by the Secretary how often the list was purged, Mr. Hopkins said, "When they were put on, December of last year." He also said that no visits were made to families now for the purpose of "checking" because such visits would require administrative machinery of an enormous size and, according to the advice of the staff of WPA, home visits would not result in throwing off more than 3% to 5%. The last house check was made in May, 1935.

HM,Jr. explained to the group that when the matter is ready for presentation to the President, he would not fight on the number of people who need work, but would fight on who is to do the administrative job and what kind of projects there should be. He will remind the President that he gave a figure of $840 per man per year, yet there are a lot of projects that start at $4,000 a year. He said he will ask the President to help him keep the figure of $840 and the only way HM,Jr. can see to do that, he said, is to "do a job for the human beings -- on July 1, have a New Deal."

Using Harry Hopkins' figure of 3½ million to whom employment should be given next year through the Works program, HM,Jr. said "We have to make the money meet. Ninety percent of the 3½ million people will have to come from the certified relief rolls and the average must be $840 per man. There can be no more buying of $25,000,000 worth of land." He called the attention of the group to the fact that Mr. Taylor is of the opinion that this is the time, with the new Soil Erosion Act, to straighten out the difference between soil conservation and reclamation and, incidentally, to save a lot of money. HM,Jr. will recommend to the President that we start right in and have a complete housecleaning.

He will say to the President, "If you want $1,860,000,000 and have a $1,000,000,000 carryover, you can do it." HM,Jr.

told the group, "I am going to fight on that; not on how many people should get work." He repeated, "I am going to fight on who is to do the administrative work and what kind of projects there should be."

Harry Hopkins remarked that the point the Secretary made was the most important one. Bell also agreed. Hopkins, following the lines of Mr. Morgenthau's idea, said it was necessary to have a meeting of minds, in asking for money for extra purposes, that it should be asked for exclusively in the interest of the unemployed, needy people and not in the interest of a program in which they are secondary or down the line. Again Bell agreed with this. Hopkins said he had told the Budget repeatedly that everybody is of the opinion that the $4 billion 8 has been appropriated for relief. "You know that is not so and there is nothing you can say about it," he stated. "The record is always that the money is going to relief, but in reality we only got about half of the $4 billion 8 for relief," he continued. "We have given 85% of the money we have received for relief. Tugwell ducks his position all the time. This is on our door-step every morning. I have never told anybody that I can't do this or that because we do not have the money; we have always met the thing head on, but the other fellows just keep ducking. I am getting darn sick and tired of this. The people we are handling are the people who don't eat unless we give them relief. We want to see one bill for WPA and not let anybody ride in on the coat-tails of this bill." Bell was of the opinion that the situation justifies such action, because included in the Budget are the Reclamation projects and the River and Harbor program and the only thing not included, he said, is the Relief item, and Tugwell and Ickes programs.

HM, Jr. announced that there would be another meeting in his office tomorrow morning at 10:15.

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The group departed with the exception of Bell, Hopkins and Gill who remained for further discussion with the Secretary.

Hopkins said, "We want a meeting of minds on the money that we need for the balance of the year. Gill said $250,000,000 is the lowest estimate and that $300,000,000 is a better estimate. The difficulty," he continued, "is knowing what the other agencies are going to do in the spring. We sent out a statement (copy attached) which gives a top figure of 2,792,990 people as the maximum number to be employed on State WPA projects for the last quarter of the present fiscal year. We dropped it over 700,000."

HM, Jr. said, "The President has made the flat statement that the top figure he would ask Congress for on relief would be $2,136,000,000. The other night the Democratic leaders told the President that he could not have over $1,000,000,000 for relief. The only way I can see how the President can keep within his figure is to first figure out what we need for relief on July 1. We will have $1,000,000,000 carryover. Then the President will have to O.K. the 300,000 families which Tugwell is looking after, because we must get this money. We will not build anything that does not put people to work. In order to accomplish this, Tugwell and Ickes will have to discontinue any new projects and all the new money should go exclusively to Harry Hopkins. It will be a great shock to the President, but he must be consistent and if he is, he will win.

He is turning the Senators down every day. Someone came and said that he must do this or do that because if he does not, he will lost Colorado. I think it was Senator Adams. And the President said, 'Well, I will just have to lose Colorado'".

Harry Hopkins, surprised, asked "Is the President taking that attitude," HM, Jr. replied, "Absolutely!" The President has completely changed and these are some of the things he is doing. I think it would be easier, from the President's standpoint, if only one bill for relief were provided. Nothing else! And that the President absolutely should not weaken. The President may then turn to us and say, 'What am I going to do with all these projects,' I am going to reply, 'Let's examine them.' I think the best advice that I can give him

is that he should have one relief bill and only for relief. As far as I am concerned, I do not care whether it is $1½ billions or $2 billions as long as he stays within the $2,136,000,000. This is the figure he used in his Budget Message."

Harry Hopkins asked Mr. Gill, "Why do we need $250,000,000 more to complete this year," and Gill answered, "All the money will be given out by May 1. That is, money we have given to the States. What we need is money to operate on for May and June. That's the way the machinery is set up." But Hopkins persisted and again asked, "Why do we need $250,000,000," Gill explained, "The money that is now in the States' hands will run out by May 1."

As stated above, there will be another meeting tomorrow morning.

Not for Publication

Blgk

Maximum Number to be Employed on State W.P.A. Projects
(March through June 1936) 1/

	March 31	April 15	April 30	May 15	May 31	June 15	June 30
U. S. Total	2,792,900	2,626,300	2,494,200	2,406,800	2,332,300	2,291,900	2,278,300
Alabama	41,900	40,900	39,900	38,900	37,900	36,900	35,900
Arizona	12,000	11,000	10,000	10,000	10,000	10,000	10,000
Arkansas	36,000	33,000	31,000	30,000	30,000	30,000	30,000
California	142,450	134,450	129,450	124,450	119,450	114,450	109,450
Colorado	37,750	34,750	32,750	32,750	31,750	30,750	29,750
Connecticut	27,400	24,400	23,400	22,400	21,400	20,900	20,400
Delaware	3,400	3,100	2,800	2,600	2,500	2,400	2,400
District of Columbia	8,700	8,300	7,900	7,700	7,400	7,200	6,900
Florida	31,300	29,300	27,300	27,300	27,300	27,300	27,300
Georgia	45,850	41,850	39,850	38,850	37,850	37,850	37,850
Idaho	13,500	12,000	11,000	10,000	9,500	9,000	9,000
Illinois	185,900	178,900	171,900	167,900	157,900	157,900	157,900
Indiana	82,250	77,750	74,750	71,750	69,750	69,750	69,750
Iowa	31,850	29,850	24,850	22,850	20,850	19,850	19,850
Kansas	42,400	39,900	37,400	35,900	33,900	33,900	32,900
Kentucky	64,900	56,900	51,900	49,900	47,900	45,900	44,900
Louisiana	44,800	39,800	37,800	35,800	34,800	34,800	34,800
Maine	9,600	8,800	8,300	7,800	7,600	6,800	6,800
Maryland	19,000	17,000	16,500	16,000	15,500	15,000	15,000
Massachusetts	111,300	106,300	101,300	97,300	93,300	91,300	89,300
Michigan	93,550	89,550	85,550	83,550	81,550	81,550	81,550
Minnesota	61,600	56,600	53,600	51,600	49,600	46,600	46,600
Mississippi	33,850	29,850	27,850	25,850	24,850	24,850	24,850
Missouri	84,800	79,800	74,800	72,800	70,800	69,800	69,800
Montana	16,000	15,000	14,000	13,300	12,500	12,100	11,600
Nebraska	21,700	20,700	18,700	17,200	16,000	15,200	14,700
Nevada	2,800	2,700	2,500	2,300	2,200	2,100	2,000
New Hampshire	9,350	8,650	8,050	7,650	7,350	6,850	6,850
New Jersey	93,550	89,550	85,550	82,550	80,550	78,550	78,550
New Mexico	12,000	11,000	10,000	9,400	9,000	8,500	8,500
New York City	221,600	209,600	201,600	196,600	194,600	191,600	191,600
New York: Up-state	128,750	121,250	113,750	108,750	103,750	103,750	103,750
North Carolina	39,850	36,850	34,850	33,850	32,850	32,850	32,850
North Dakota	13,500	12,500	12,000	10,000	9,000	8,500	8,500
Ohio	176,600	168,600	162,600	158,600	153,600	148,600	148,600
Oklahoma	74,850	64,850	59,850	57,350	54,850	54,850	54,850
Oregon	19,850	18,850	17,850	16,850	16,350	15,850	15,850
Pennsylvania	275,750	264,750	254,750	248,750	248,750	248,750	248,750
Rhode Island	14,750	13,750	12,750	12,250	11,750	10,750	10,750
South Carolina	30,000	28,000	26,000	25,000	25,000	25,000	25,000
South Dakota	14,500	13,500	13,000	11,500	10,500	10,000	10,000
Tennessee	44,900	42,900	40,900	38,900	37,900	36,900	36,900
Texas	101,650	94,650	89,650	87,150	84,650	84,650	84,650
Utah	15,500	14,500	13,700	13,200	12,700	12,400	12,000
Vermont	5,500	5,000	4,700	4,100	3,500	3,300	3,000
Virginia	34,800	32,800	30,800	29,800	28,800	28,800	28,800
Washington	38,750	37,250	35,750	33,750	31,750	30,750	30,750
West Virginia	52,900	50,900	47,900	45,900	44,900	43,900	43,900
Wisconsin	62,150	59,650	57,150	54,650	53,150	49,650	49,650
Wyoming	5,300	4,500	4,000	3,500	3,000	3,000	3,000

1/ Excludes employees of NYA; Nation-wide Art, Music, Theatre, and Writers projects; area statistical offices; and Federal Research Projects.

Not for Publication

8434

Maximum Number to be Employed on State W.P.A. Projects
(March through June 1936) 1/

	March 31	April 15	April 30	May 15	May 31	June 15	June 30
U. S. Total	2,792,900	2,626,300	2,494,200	2,406,800	2,332,300	2,291,900	2,278,300
Alabama	41,900	40,900	39,900	38,900	37,900	36,900	35,900
Arizona	12,000	11,000	10,000	10,000	10,000	10,000	10,000
Arkansas	36,000	33,000	31,000	30,000	30,000	30,000	30,000
California	142,450	134,450	129,450	124,450	119,450	114,450	109,450
Colorado	37,750	34,750	32,750	32,750	31,750	30,750	29,750
Connecticut	27,400	24,400	23,400	22,400	21,400	20,900	20,400
Delaware	3,400	3,100	2,800	2,600	2,500	2,400	2,400
District of Columbia	8,700	8,300	7,900	7,700	7,400	7,200	6,900
Florida	31,300	29,300	27,300	27,300	27,300	27,300	27,300
Georgia	45,850	41,850	39,850	38,850	37,850	37,850	37,850
Idaho	13,500	12,000	11,000	10,000	9,500	9,000	9,000
Illinois	185,900	178,900	171,900	167,900	157,900	157,900	157,900
Indiana	82,250	77,750	74,750	71,750	69,750	69,750	69,750
Iowa	31,850	29,850	24,850	22,850	20,850	19,850	19,850
Kansas	42,400	39,900	37,400	35,900	33,900	33,900	32,900
Kentucky	61,900	56,900	51,900	49,900	47,900	45,900	44,900
Louisiana	44,800	39,800	37,800	35,800	34,800	34,800	34,800
Maine	9,600	8,800	8,300	7,800	7,600	6,800	6,800
Maryland	19,000	17,000	16,500	16,000	15,500	15,000	15,000
Massachusetts	111,300	106,300	101,300	97,300	93,300	91,300	89,300
Michigan	93,550	89,550	85,550	83,550	81,550	81,550	81,550
Minnesota	61,600	56,600	53,600	51,600	49,600	46,600	46,600
Mississippi	33,850	29,850	27,850	25,850	24,850	24,850	24,850
Missouri	84,800	79,800	74,800	72,800	70,800	69,800	69,800
Montana	16,000	15,000	14,000	13,300	12,500	12,100	11,600
Nebraska	21,700	20,700	18,700	17,200	16,000	15,200	14,700
Nevada	2,800	2,700	2,500	2,300	2,200	2,100	2,000
New Hampshire	9,350	8,650	8,050	7,650	7,350	6,850	6,850
New Jersey	93,550	89,550	85,550	82,550	80,550	78,550	78,550
New Mexico	12,000	11,000	10,000	9,400	9,000	8,500	8,500
New York City	221,600	209,600	201,600	196,600	194,600	191,600	191,600
New York: Up-state	128,750	121,250	113,750	108,750	103,750	103,750	103,750
North Carolina	39,850	36,850	34,850	33,850	32,850	32,850	32,850
North Dakota	13,500	12,500	12,000	10,000	9,000	8,500	8,500
Ohio	176,600	168,600	162,600	158,600	153,600	148,600	148,600
Oklahoma	74,850	64,850	59,850	57,350	54,850	54,850	54,850
Oregon	19,850	18,850	17,850	16,850	16,350	15,850	15,850
Pennsylvania	275,750	264,750	254,750	248,750	248,750	248,750	248,750
Rhode Island	14,750	13,750	12,750	12,250	11,750	10,750	10,750
South Carolina	30,000	28,000	26,000	25,000	25,000	25,000	25,000
South Dakota	14,500	13,500	13,000	11,500	10,500	10,000	10,000
Tennessee	44,900	42,900	40,900	38,900	37,900	36,900	36,900
Texas	101,650	94,650	89,650	87,150	84,650	84,650	84,650
Utah	15,500	14,500	13,700	13,200	12,700	12,400	12,000
Vermont	5,500	5,000	4,700	4,100	3,500	3,300	3,000
Virginia	34,800	32,800	30,800	29,800	28,800	28,800	28,800
Washington	38,750	37,250	35,750	33,750	31,750	30,750	30,750
West Virginia	52,900	50,900	47,900	45,900	44,900	43,900	43,900
Wisconsin	62,150	59,650	57,150	54,650	53,150	49,650	49,650
Wyoming	5,300	4,500	4,000	3,500	3,000	3,000	3,000

1/ Excludes employees of NYA; Nation-wide Art, Music, Theatre, and Writers projects; area statistical offices; and Federal Research Projects.

March 3, 1936.

March 4, 1936

Mr. Morgenthau today told Lochhead to send a message to Buck and have him ~~to~~ inform Dr. Kung, he in turn to inform P. K. Chen, that during Chen's visit to the United States it would make it very much easier for both of us if he would confine his discussion to the monetary question.

COPY

March 4, 1936

Memorandum for Mrs. Friedman:

Please transmit the following Cables:

Cable to Professor Buck

"Please suggest to Kung that if K. P. Chen is instructed to confine his conversations while in the United States to monetary subjects it will probably be helpful to both Chen and Secretary Morgenthau".

Cable to Treasury Attache Nicholson

"Refer your Cable March 3. No objections your spending time desired at San Francisco. Morgenthau".

Archie Lochhead,
Technical Assistant.

AL:ek

TREASURY TO BUY CANADIAN SILVER ONLY THROUGH BANK OF CANADA 12.05

WASHN - SECY MORGENTHAU ANNOUNCED TODAY THAT HEREAFTER THE TREASURY WOULD BUY CANADIAN NEWLY MINED SILVER ONLY THRU THE BANK OF CANADA THIS ARRANGEMENT WILL PLACE CANADIAN PURCHASES UNDER A SYSTEM SIMILAR TO ONE ALREADY APPLIED TO MEXICAN PURCHASES WHICH ARE HANDLED SOLELY THRU THE BANK OF MEXICO- THE TREASURY INSISTED THAT THERE WAS NO SIGNIFICANCE IN THE ANNOUNCEMENT EXCEPT THAT IT WILL CENTRALIZE THE TREASURY-S OPERATIONS IN NEWLY MINED CANADIAN SILVER THE V FORMAL ANNOUNCEMENT READ-

-SECY MORGENTHAU ANNOUNCED TODAY THAT HE HAD AUTHORIZED THE FEDERAL RESERVE BANK OF NY AS FISCAL AGENT OF THE U S TO PURCHASE THRU THE BANK OF CANADA IN AMOUNTS SPECIFIED BY THE TREASURY DEPT SILVER NEWLY MINED WITHIN THE DOMINION OF CANADA-

MAR 4 1936

March 5th 1936

After carefully thinking the matter through I decided that it was inadvisable for me to talk to the President in advance of the meeting tonight at the White House on relief. The reasons for my coming to this conclusion was that I want the President to get the whole picture from Hopkins first and let him realize that it is almost impossible to get the money that Hopkins needs, namely 250 million dollars to last him for the balance of this fiscal year (to July 1, 1936).

When the President finds how difficult it is I hope and believe that he will turn to me for suggestions and that will be my opportunity to speak my mind about the present situation and particularly give him my viewpoint as to what should happen after July 1, to wit: That whatever amount of money we vote for relief after July 1 every single cent must be given to the Hopkins' organization and the other hundreds of projects which are living off the four billion eight to be wound up out of whatever funds remain in the four billion eight after July 1. That is my program.

March 6th

Last night at the White House Bell, Hopkins, Gill and myself. After much conversation getting nowhere Hopkins asked me to express my views which I did. I told the President that I thought that this was one of the most difficult problems that I have ever been called in on; that in view of three years experience I felt that beginning with July 1 all relief should be handled by one department; that the relief work which Tugwell is doing for farmers should be transferred back on July 1 to Hopkins; that I knew that this would be agreeable to Tugwell; that both from an administrative, humanitarian and political standpoint this would be a move in the right direction. Furthermore, when we tried to get the money from Congress for relief, if we stated that all the money that we asked for would go exclusively for relief, that I felt our chances for getting the bill through would be greatly enhanced; that the existing organizations who are getting their money out of the 4 billion 8 would have to get their money either in the regular way or be wound up.

Hopkins pointed out that his total administrative expenses were 5 million a month and that Tugwell's were 3 million a month and that he, Hopkins, could handle the farm families for considerably less money than Tugwell. After some further discussion, to my great surprise, the President agreed to this basis, namely, that the new relief bill would ask for x number of millions of dollars to be used exclusively for relief and all of it to be given to Hopkins.

I then continued and said that we have two fixed poles between which we have to operate. On the one hand Hopkins says for next year we must look after an average of 3½ million people. On the other hand you, Mr. President, have fixed the outside figure for relief in your budget at 2 billion 137 million dollars. I said, "if we take the present rate of spending as a basis and say the conditions will not be any better next year; that the weather conditions will be as severe, I then estimate that from July 1, 1936 to December 31, 1936 we will spend on an average of 150 million a month or a total of 900 million in the first six months. In the second 6 months, if we spend at the same rate as we are now spending, we will spend 160 million dollars a month or a total of 960 million for the second six months, or a total of 12 months of 1 billion 860 million dollars. Add to this 100 million to continue to look after Tugwell's farm families and you reach the figure of 1 billion 960 million". The President then said, "but you cannot take care of as many people as we are now with that figure" and I said, "oh yes you can, Mr. President, because after July 1 you still will have 1 billion left out of the 4 billion 8. You have 450 million in the Public Works Bill and 300 million for CCC (that is for 12 months) which would give you a total of 3 billion 710 million and I say that with that

amount of money that you can take care of at least as many people as you are now" and Hopkins agreed. During this argument the President said once to me, "oh Henry you are going to take bread away from starving people" and I said, "oh I am not. You can't say that to me when up to date Hopkins, for relief purposes, has gotten less than half the money out of 4 billion 8" and that ended that argument.

I could tell that the President was very much surprised and pleased at the thought that he might be able to do this job for 1 billion 960 million dollars and I was just about ready to say, "three cheers" when he went back to the proposition that he spoke to me about last Saturday and in sketching it he said he had spoken to three more people about this proposition which is as follows: He would ask Congress for 1½ billion saying that if industry could put another million men to work that we could get along with 1½ billion dollars but if industry did not respond and put these men to work we could not get along with 1½ billion dollars and he would have to come back and ask Congress for more money. I then got pretty excited and said, "Mr. President, you will not fool anybody with this trick because you are not saying that when you come back to Congress what the amount of money will be that you are going to ask for and whether it will be the difference between 1½ billion and two billion 136 million, namely, 636 million". So he answered, quick as a flash, "oh no I am not going to tie my hands and that would be spoiling my whole plea". So I said, "Mr. President, you know perfectly well that industry is not going to put any such amount of people back to work and you are not fooling anybody and the only people who are going to suffer are the unemployed who will not know where they are at. Why don't you tell Congress that you want 1 billion 960 million and that if industry puts people back to work that you will use that much less money". He said, "no, no that will not do at all, that spoils my whole plea". I then said, "why not ask for enough money to last you until February 1". He said, "no, that will not do".

Well after considerable arguing back and forth, I begging him not to leave the amount for relief vague and up in the air, I finally got him so that he made the following suggestion himself: That he would say to Congress that, "I need for the bare necessities to keep the unemployed alive 1 billion 960 million dollars but if industry will come through and do its part and take on after July 1 one million more men I will not need that much money and, therefore, I now ask Congress for only 1½ billion and will wait and see what industry does". I told him that this was satisfactory to me because in this final suggestion that he made he set a top limit that he would ask Congress in the next fiscal year of 1 billion 960 million dollars and not leave it open so that he can go back and subsequently ask Congress for more money over and above his two billion 136 million dollars.

When we left him last night he had agreed to everything that I wanted but I did not have an innermost feeling that he would stay sold on the idea that he would definitely tie his hands and not ask for more than 2 billion 136 million within the next fiscal year.

TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE,
Friday, March 6, 1936.

Press Service
No. 6-97

Secretary of the Treasury Morgenthau today announced the subscription figures and the bases of allotment for the cash offering of 2-3/4 percent Treasury Bonds of 1948-51 and of 1-1/2 percent Treasury Notes of Series A-1941.

Reports received from the Federal Reserve banks show that subscriptions for the cash offering of Treasury bonds, which was for $650,000,000, or thereabouts, aggregate $5,106,000,000. Subscriptions in amounts up to and including $5,000 were allotted in full and those in amounts over $5,000 were allotted 13 percent, but not less than $5,000 on any one subscription.

For the cash offering of Treasury notes, which was for $600,000,000, or thereabouts, subscriptions aggregate over $3,353,000,000. Cash subscriptions in amounts up to and including $5,000 were allotted in full and those in amounts over $5,000 were allotted 18 percent, but not less than $5,000 on any one subscription.

The subscription books for both issues closed last night, March 5, for the receipt of exchange subscriptions in payment of which Treasury Notes of Series C-1936, maturing April 15, 1936, were tendered. Preliminary reports indicate that practically all of the maturing notes will be exchanged for the new issues, and that about 90 percent of the exchanges are for the bonds.

Further details as to subscriptions and allotments will be announced when final reports are received from the Federal Reserve banks.

ooOoo

March 6, 1936

The Vice President asked the Secretary to do something for John C. Turman, a Customs Patrol Inspector in the San Antonio District.

Turman was appointed in 1934 with the approval of the Civil Service Commission subject to examination. He was not admitted to the examination when it was given, however, on the theory that he lacked the required experience as a peace officer. McReynolds reported that his experience in the cattle business, on the other hand, seemed to qualify him particularly well for the position he has.

The Collector of Customs will retain Turman on his rolls until instructed to the contrary. It may be necessary to have an Executive Order to retain him permanently.

Mr. Garner expressed his appreciation of HM,Jr's help.

March 6, 1936

In the opinion of all the Treasury people and the legislative drafting people on the Hill, it will be fatal to the proposed tax if it is butchered with exceptions. The most serious threat is the talk about special provisions to enable corporations to accumulate surplus--that is, provisions in addition to those now contained in the present law allowing deductions from income to cover depreciation and depletion.

Putting in any such provisions is an abandonment of the principle of equality which is the fundamental basis on which this law is to be defended and no good reasons for any such special provisions have been advanced. The corporations operated for business and not for tax evasion normally keep back from stockholders about 25 to 30 per cent. They can continue this practice under the proposed law and their total Federal tax bill will only be from one-half to three-quarters of what it is under existing law. Indeed, they can keep back half of their earnings, paying 33 per cent on that half which would be 16½ per cent on their total earnings, or about what they pay now. When a new corporation is formed, it can get capital only by drawing on funds that have been through the surtax mill. There is no reason for allowing existing corporations to repair or build up their capital whether in the form of capital stock or surplus by using funds that have not paid the surtaxes. It would amount to a bonus or subsidy to private businesses and frequently to poorly managed private businesses. How the proposal would destroy the principle of equality, which is the basic merit of this new tax,

comes out clearly when it is realized that a partnership or individual in the same position cannot build up reserves without paying the surtaxes on everything they put into the reserves.

March 9, 1936

The Secretary is ill with an attack of grippe and is staying at home.

I asked Bell what happened at last night's meeting at the White House on relief, so I could report it to the Secretary. Bell said that the President talked for one hour about his forthcoming fishing trip to the Bahamas and then just reviewed what was decided at Thursday night's meeting. He also said that Harry Hopkins will furnish the President, today, with a draft of the relief message and that on Thursday night of this week there will be another meeting at the White House to discuss the message, the President in the meantime hoping to have it whipped into shape. After that meeting the President would like to call in the Congressional leaders, probably on Friday or Saturday, and get their views on his message and then he will send it to Congress the first of next week. According to Bell, the President definitely will not do anything final until HM,Jr.has had a chance to go over the program and the message.

It was the Secretary's desire that the group gather for the 9:30 meeting as usual.

A suggestion from Bell was to the effect that Gaston should try to see Senator Nye today, because the Senator did not want to print extracts from Treasury correspondence.

Upham reported that Eccles had told him he thought Case was a stuffed shirt -- just a rubber stamp of his son's father-in-law. Upham also personally spoke unfavorably of Case and Bell was not favorably inclined towards Case.

Miss Roche told the group that all of the money under the Social Security Act has been allotted to the States and they are all satisfied. Gaston will give out a story to the press on it.

I told the Secretary that Lochhead reported foreign exchanges are all slightly better. Sterling is quoted at 4.98½ and francs, 6.65½. There does not seem to be so much tension on the other side. They are just talking about things instead of taking any action. Silver is 19-9/16, equivalent to 43.87 as compared to 44.06 yesterday.

March 6, 1936

Wideman came in today to see Mr. Morgenthau. He said, "The Attorney General has asked me to handle Associated Gas and my purpose in coming to see you is to ask whether you could not arrange with Mr. Edward S. Greenbaum to continue to handle the Associated Gas case; that is, to take it to the higher Court." HM,Jr. replied, "I think it would be a courteous thing to ask Mr. Greenbaum, but I doubt whether he will do it, but I do not want to ask him myself. I think the Attorney General should do so."

Mr. Wideman also said, "We filed a Bill of Complaint and tried to get it in the hands of the Court. I talked to Judge Mack, who is to hear the bankruptcy proceedings. From 10 to 12 lawyers have been retained for that hearing. I am not going to talk to any of them. Trammell has called me and I am not going to talk to him. The Associated people will have to appoint two reputable lawyers and I will talk to them."

HM,Jr. then told Mr. Wideman the following. He said, "I am delighted that you have Associated Gas. I am tremendously interested and I hope you will keep me posted. I am interested in the Louisiana tax case and the Associated Gas. There is more dirty political pressure connected with these than anything else I have had since I have been in the Treasury."

March 10, 1936

HM,Jr. is ill at home today. He wanted a staff meeting held as usual, however.

Mr. Bell reported that a bank in New Jersey on March 4 had bought some Treasury notes maturing April 15 paying 101½, with the intention of exchanging them for 2¾% bonds. They handed the subscription to one of their bond men who was going to New York and told him to either put it in the mail or turn it in to the Federal Reserve Bank, but the boy forgot to do so. The Bank has filed an affidavit stating the facts and asking the Treasury to accept their subscription to the notes in exchange for the notes. The difficulty is, however, that the Treasury had closed its books before receipt of the affidavit. Wayne Taylor said he is very sorry for the young man, who is 26 years old, and also feels badly that because of the slip-up the bank is out some $37,000. Opper is working on it. Bell feels that there is some merit to the case, but says there will have to be a legal opinion before a decision can be made.

Gibbons said he had received a letter from Admiral Peoples telling him that various Federal buildings will soon be ready for dedication and that he would like representatives of the Treasury Department to be present. Gibbons also reported that Gaston made a wonderful speech explaining the tax program at the luncheon given Saturday at the Manhattan Club in New York City by Mr. Durning.

Miss Roche reported a good meeting in Minneapolis with 900 people present. She also said that the National Jewish Hospitals are having a convention here on the 29th of March and would like Secretary Morgenthau to say a few words to them. She was told that HM,Jr. would be away at that time.

Peter Grimm is ready to talk to the Secretary on the Slum Clearance plan. He said he had a talk with Senator Wagner last week and is seeing him again tonight.

Mr. Gaston reported that the newspaper boys who were at the conference last night at the Secretary's home were asking for figures to complete the table, prepared by Haas, on distribution of profits under the new plan by income classes of individuals -- how much is undistributed and if it were distributed, where it would go and how much it would increase various dividend classes. Haas and Oliphant both said the Committee should have it before Gaston gives it to the press.

March 11, 1936

About a week ago, Doughton recommended to the Secretary that Congressman Samuel Hill replace Robert Jackson. Oliphant called on the Secretary at his home this morning before coming to the office and HM,Jr. told Oliphant to get in touch with Doughton and to give him this message, "That thing that the Secretary said he would talk to you about has not been overlooked, but he has not gotten to it on account of illness."

At the 9:30 meeting this morning, Oliphant reported that he had told the Secretary about Doughton's suggestion in regard to liquor tax and that Graves had given him, Oliphant, the following figures: that if we put a tax of $1.00 a barrel on beer and $1.00 a gallon on whiskey that those taxes and the "windfall" tax would take care of everything and it would not be necessary, therefore, to have any processing tax.

After the 9:30 meeting was over, Oliphant came back and questioned me about Frank Wideman's visit, last week, to the Secretary. I told him that Mr. Morgenthau told Wideman that he should get in touch with Mr. Greenbaum directly and personally make the proposition to him that he continue to handle the Associated Gas tax case, but that he, HM,Jr., did not want to discuss it with Mr. Greenbaum. Oliphant said that since no word has come from either Wideman or Greenbaum that he thought McReynolds should get in touch with Wideman and follow it through.

Thursday
March 5, 1936

HM,Jr: Hello -

Herman Oliphant: Hello -

HM,Jr: Hello, Herman?

O: Yes

HM,Jr: I tell you what Bob Doughton wanted and I think it's a very interesting suggestion.

O: Yes

HM,Jr: He's suggesting Sam Hill for the lawyer over there in Internal Revenue -

O: Yes, I had heard that.

HM,Jr: I - sounds awfully good to me. Did you know - ?

O: Oh, yes - Henry, it isn't, I want to talk to you about it.

HM,Jr: It isn't?

O: Oh, no, it isn't.

HM,Jr: Why not?

O: Well, I want to talk to you about it. I've got - it's eight minutes until that hearing opens and I've got to run.

HM,Jr: O. K. I told him I wouldn't let him know until Monday night.

O: I want to talk to you

HM,Jr: You do?

O: Yes - I think you ought to talk to Kent and Jackson

HM,Jr: Well, I'll talk to you. You run.

O: O. K.

HM,Jr: Goodbye.

Thursday
March 5, 1936

Robert Jackson: How are you this morning?

HM,Jr: All right - The Department of Justice Jackson?

J: Yes (Laughter)

HM,Jr: Look - Doughton was just down to see me and he suggests Sam Hill to succede you over in Internal Revenue.

J: Well, - he talked with me one night out at the Wardman Park Hotel where he lives and I live -

HM,Jr: Yes

J: And I could see that he had that in his -

HM,Jr: Yes

J: - in his mind. Hill is a nice fellow.

HM,Jr: Yes

J: But I question very much if he would handle the administrative work of that office particularly well.

HM,Jr: I see.

J: - Do you know him?

HM,Jr: Well, just appearing before him, that's all.

J: I think if you would talk with him fifteen minutes you would see that he is not at all the executive type.

HM,Jr: Yes

J: And you do need in that office more of an executive type than anything else.

HM,Jr: Yes, Well, of course I think, I don't know how you feel about it, but I think it's out of the question to make Kent head of that office on account of his not being a lawyer.

J: Well, it's one of those things tha , on the merits of his ability he could handle it without any question.

HM,Jr: Yes

J: The difficulty is the way these people look at it and that - you can't argue that out of existence.

HM,Jr: No - I mean if our own Democratic friends feel that way

what chance have we got to get him confirmed?

J: Yes, that's the difficulty.

HM,Jr: And - at this time I don't want - I don't want a big discussion on 'Brain Trust'. I looked up his record, I think he taught psychology or something like that. He wasn't a tax man.

J: Well, he was in Chicago.

HM,Jr: Was he?

J: Oh, yes He taught Constitutional Law and - and Taxation.

HM,Jr: I see. But you - you'd think twice before you put Hill?

J: Yes, I would, I'd think -

HM,Jr: What do you think about Hill for the Board of Tax Appeals?

J: Well, he might do all right for that.

HM,Jr: Yes

J: That would be much nearer his pace.

HM,Jr: I see.

J: I think that this man Dorsey that Oliphant spoke to me about -

HM,Jr: Yes

J: Would be a much more capable executive, -

HM,Jr: Really?

J: - than Hill.

HM,Jr: Of course he's got such terrific political backing -

J: Yes

HM,Jr: Dorsey -

J: Yes, he has.

HM,Jr: Do you know him at all?

J: Yes, I know him but not intimately.

HM,Jr: Yes

J: But I have nothing but good of his work in the Home Owners Loan Corporation.

HM,Jr: Really?

J: He seems to be capable of handling men. I knew quite well his work setting up that Buffalo Office and the Western New York Office and he seems to be a very capable fellow. I -

HM,Jr: Yes

J: I don't know his - his slant on these things -

HM,Jr: I see.

J: - in matters of policy within our shops.

HM,Jr: Well, I'll talk to you again -

J: All right

HM,Jr: How are you getting along?

J: Very well

HM,Jr: Good

J: Very well - I'm working on my first argument and getting it ready for Supreme Court -

HM,Jr: Fine

J: Very interesting

HM,Jr: Fine - all right, Thank you.

J: All right

HM,Jr: Goodbye.

J: Goodbye.

March 11, 1936.

There were present at the 9:30 meeting Mr. Gaston, Mr. Oliphant, Mr. Bell, Mr. Taylor, Mr. Gibbons, Mr. McReynolds and Mr. Upham. Mr. Grimm excused himself just as the meeting began.

A number of things were discussed.

Mr. Gaston told Mr. Bell that he planned to get in touch with Senator Nye very shortly on the question of printing extracts from Treasury correspondence prior to and during the war.

Mr. Bell remarked that he thought Senator Copeland sent us a very sarcastic reply to the letter in which we attempt to answer his question comparing the yield on Government bonds with those on state bonds and municipals.

Mr. Oliphant reported that the discussion by the Ways and Means sub-committee on the tax bill late yesterday took the turn of "how can we keep Pat Harrison from changing our bill". He reported that the members of the sub-committee are extremely keen in their questioning and that Vinson of Kentucky is the most intelligent of the lot -- and the most ruthless.

There was some discussion of the relationship of the Treasury and the State Department to the Omnibus Liquor Bill, with particular reference to the Canadian situation.

Mr. McReynolds reported that it was the opinion of the Secretary that the Treasury ought to maintain their position. At this point Miss Chauncey came in and read a message from the Secretary reporting the attitude of the President on the matter under discussion.

Mr. Oliphant said that the members of the committee know who are the Canadian backers of Seagram and that the Republicans on the committee are supporting the Treasury position and putting the Democrats on the spot. He said that Bennett Clark will ask the State Department some very embarrassing questions if they appear.

Mr. Taylor commented that the State Department is under some obligation to present the Canadian side to the committee.

Mr. Oliphant said he thought Under Secretary Phillips ought to know that Secretary Morgenthau plans to "go through" with the Treasury plan.

There was some mention of possibility of seeing who was stronger in Canada, the silver group or the liquor group.

Mr. Gaston asked for the consensus on whether he should attempt to secure a private audience with the President for Peter Grimm either prior to or following a meeting of housing agency heads at the White House at 2 o'clock today.

It seemed to be the opinion of those present that he should not.

There was some discussion of the proposals that are to be advanced at the housing meeting.

Mr. Gaston explained that Mr. Fahey is proposing to use the proceeds of from $200 million to $300 million of HOLC bonds for making second mortgages up to 20% of appraised value on ordinary commercial offerings and for making 10% second mortgages on properties covered by FHA insured first mortgage.

It seems that Mr. Jones is for the FHA proposal with the understanding that the RFC will make initial loans on apartment house properties up to 80%. It will be insured by the FHA and resold, if possible, by the RFC.

Mr. Grimm, on the other hand, seems to favor extending the time for the formation of National Mortgage Associations and permitting them to issue debentures in a higher proportion to their capital.

Mr. Oliphant raised the question of how far the area of Treasury policy should extend into fields normally outside its bailiwick. It was his feeling that Mr. Grimm's job should be to coordinate rather than to formulate policies.

Mr. Taylor gave his off hand judgment of Government engaging in equity financing and real estate as "very wet".

Mr. Gaston referred to some memoranda which had been received by the Treasury from the President a few days ago wherein the proposal had been made for a Government 40% second mortgage as a possible indication of Presidential favor for this type of activity.

It was recalled that the President had instructed the housing group to formulate a program and bring to him their disagreements, if any. It was thought that it might prove embarrassing to the Secretary later if Mr. Grimm were encouraged to see the President privately, either before or after the 2 o'clock meeting in an attempt to explode the Fahey proposal.

March 11, 1936

On the basis of the attached memorandum from Oliphant, the Secretary today approved sending a letter to the Department of Justice outlining the Treasury's position. Copy of letter to Justice is also attached.

GENERAL COUNSEL
TREASURY DEPARTMENT
WASHINGTON

MEMORANDUM FOR SECRETARY MORGENTHAU:

Re: Tax Case of James E. Watson.

The case involving former Senator Watson of Indiana and his son was formally referred to the Department of Justice for consideration of prosecution some time ago, together with an offer in compromise in the amount of $10,000.00 made on behalf of the taxpayer by some of his friends.

A letter has just been received from the Department of Justice, signed by Mr. Jackson for the Attorney General, stating the view of the Department that it is unlikely that a conviction can be obtained on the evidence available. This view is shared by the United States District Attorney at Baltimore where an indictment covering the year 1929 would have to be obtained, the Senator's return for that year having been filed with the Baltimore Collector. The case for 1929 is decidedly stronger than that for 1930. The prosecution for the latter year would have to be brought in Indiana. It is unfortunate that this complicating circumstance exists, for it is inevitable that wrong inferences would be drawn from prosecution of the taxpayer out of his home district. The case for the year 1930, standing alone, is decidedly weak.

The Department of Justice has requested our recommendation as to the acceptance of the offer in compromise, which is likely to be increased in amount to at least $15,000.00, contingent upon proof that it exceeds the amount collectible from the taxpayer, who is said to be broke. I believe that the Treasury Department would not be warranted in interposing any objection to the disposition of the case upon this basis, in view of the improbability that a conviction can be obtained. An acquittal in a case of this type would tend to have a very prejudicial effect on income tax prosecutions generally. It is proposed to inform the Department of Justice to this effect.

General Counsel.

MAR 11 1936

Honorable Robert H. Jackson,
Assistant Attorney General,
Department of Justice,
Washington, D. C.

In re: James E. Watson,
Rushville, Indiana.

Sir:

Reference is made to your letter of March 6th, addressed to Honorable Herman Oliphant, General Counsel, in which you state that careful consideration of the above-entitled case has led you to the conclusion that a conviction in all probability could not be obtained if it were to be tried. In the body of your letter you set forth a number of facts and circumstances which militate against a successful prosecution and attach a copy of a letter from United States Attorney Flynn in Baltimore, where the 1929 case would have to be tried, expressing his belief that a conviction could not be obtained.

You express the view that, under the circumstances, it is desirable to settle the case by way of compromise and request the recommendation of the Treasury Department as to the acceptance or rejection of an offer in an amount thought to be in excess of the full amount the taxpayer can pay, such amount to be determined by careful investigation.

After due consideration of the contents of your letter and all the other facts and circumstances involved, it is felt that there is no sufficient reason for any objection from the point of view of the Treasury Department to a settlement of the case by way of compromise along the lines indicated by your letter.

The machinery of the Bureau will be at your service upon request for an investigation of the adequacy of the offer from the point of view of collectibility.

Respectfully,

(Signed) Guy T. Helvering

Commissioner.

March 11, 1936

In his memorandum of March 10 covering his activities for the day, Mr. Taylor reported to the Secretary his conversation with Dr. Feis of the State Department about the letter to the signatories of the London Silver Agreement which the Treasury is considering sending. HM,Jr's reaction to this was: "O.K. to send letter at start to group who agreed to withhold silver from the market," and Mr. Taylor was so instructed.

March 11, 1936

In one of the discussions between Oliphant, Haas and the Internal Revenue men concerning possible means of raising new revenue, the suggestion was made of an increased tax of $1.00 per gallon on distilled spirits and $1.00 per barrel on beer, which, it was estimated, would produce an additional $125,000,000 in revenue. Oliphant passed this suggestion along to McReynolds, who, in turn, related it to Mrs. Klotz.

HSK, in talking to the Secretary over the 'phone, this morning, told him about the plan and he thought it a swell one. He later called Mrs. Klotz and told her he had discussed it over the telephone with the President who was also enthusiastic about it. He said the President had asked how many glasses of beer there were in a barrel and HM,Jr. did not know, but told the President he would find out. The President thought there were about a thousand glasses to a barrel. McReynolds is to get the figure which is generally used by the trade.

HM,Jr. also told Mrs. Klotz that the President had inquired what is this going to do with bootlegging and HM,Jr. wants to have material prepared with which he can answer the President's question. McReynolds, Graves and Berkshire are to get together and write a history of what the Treasury has done on bootlegging since HM,Jr. came to the Treasury. He wants McReynolds and Graves to bring this report with them to his house tomorrow morning at five minutes of nine. It might be a lengthy history giving full details, but in addition to that he wants a one-page summary.

HSK related all of the above to McReynolds and told him that the Secretary had said if he needed any help he should ask Gaston or have Gaston assign someone to work on it with them, but that the Secretary is pinning the responsibility entirely on McReynolds.

March 12, 1936.

My dear Mr. President:

For your information I am enclosing a memorandum showing that by an increased tax of $1.00 per gallon on distilled spirits and $1.00 per barrel on beer we could collect an additional $125,000,000.

I am also enclosing a report showing the action taken by the Treasury Department since repeal in enforcement of the liquor laws.

Sincerely,

Henry Morgenthau, Jr.

The President,
The White House.

ESTIMATE OF INCREASED REVENUE TO BE DERIVED DURING FISCAL YEAR 1937 FROM AN INCREASE OF ONE DOLLAR PER GALLON IN THE EXCISE TAX ON DISTILLED SPIRITS AND ONE DOLLAR PER BARREL IN THE RATE ON FERMENTED MALT LIQUORS.

Distilled Spirits

At $2 rate:

Imports	8,250,000 gallons	$ 16,500,000
Domestic	120,000,000 gallons	240,000,000
	Total	$ 256,500,000

At $3 rate:

Imports	7,425,000 gallons	$ 22,275,000
Domestic	108,000,000 gallons	324,000,000
		$ 346,275,000
	Increase	$ 89,775,000

Fermented Malt Liquors

At $5 rate,	51,300,000 barrels	$ 256,500,000
At $6 rate,	46,735,000 barrels	292,410,000
	Increase	35,910,000
	Total Increase	$ 125,685,000

Note: Above estimates assume a 10% decrease in consumption of distilled spirits and a 5% decrease in consumption of fermented malt liquors, as the result of the suggested rate increases.

It is believed that over a three year period the average annual increased revenues which would result from the suggested rate increases would approximate $140,000,000.

HM,Jr.
NMC

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Domestic	108,000,000 gallons	324,000,000
		$ 346,275,000
	Increase	$ 89,775,000

Fermented Malt Liquors

At $5 rate,	51,300,000 barrels	$ 256,500,000
At $6 rate,	46,735,000 barrels	292,410,000
	Increase	35,910,000
	Total Increase	$ 125,685,000

Note: Above estimates assume a 10% decrease in consumption of distilled spirits and a 5% decrease in consumption of fermented malt liquors, as the result of the suggested rate increases.

It is believed that over a three year period the average annual increased revenues which would result from the suggested rate increases would approximate $140,000,000.

HM,Jr.
NMC

ESTIMATE OF INCREASED REVENUE TO BE DERIVED DURING FISCAL YEAR 1937 FROM AN INCREASE OF ONE DOLLAR PER GALLON IN THE EXCISE TAX ON DISTILLED SPIRITS AND ONE DOLLAR PER BARREL IN THE RATE ON FERMENTED MALT LIQUORS.

Distilled Spirits

At $2 rate:

Imports	8,250,000 gallons	$ 16,500,000
Domestic	120,000,000 gallons	240,000,000
	Total	$ 256,500,000

At $5 rate:

Imports	7,425,000 gallons	$ 22,275,000
Domestic	108,000,000 gallons	324,000,000
		$ 346,275,000
	Increase	$ 89,775,000

Fermented Malt Liquors

At $5 rate,	51,300,000 barrels	$ 256,500,000
At $6 rate,	46,735,000 barrels	292,410,000
	Increase	35,910,000
	Total Increase	$ 125,685,000

Note: Above estimates assume a 10% decrease in consumption of distilled spirits and a 5% decrease in consumption of fermented malt liquors, as the result of the suggested rate increases.

It is believed that over a three year period the average annual increased revenues which would result from the suggested rate increases would approximate $140,000,000.

EF,Jr.
HSG

REPORT FOR THE SECRETARY

PART ONE - THE CANADIAN DISTILLERY CASES.

PART TWO - LIQUOR CONTROL IN THE TREASURY DEPARTMENT.

PART ONE

THE CANADIAN DISTILLERY CASES.

THE CANADIAN DISTILLERY CASES

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THE CANADIAN DISTILLERY CASES

On August 22, 1935, the House of Representatives passed and sent to the Senate a Bill, H.R. 9185, amending many of the provisions of the Internal Revenue and Customs laws relating to distilled spirits, wine and fermented malt liquor. The object of the Bill, which is known as the "Omnibus Liquor Bill", is in the main to modernize the legislation under which the Federal Government exercises supervision for purposes of taxation over the production, importation and distribution of intoxicating beverages. Included in the measure is a provision, specially recommended by the Treasury Department, which would have the effect of prohibiting the importation of distilled spirits, wine and fermented malt liquor produced or sold by any person against whom the Treasury had an outstanding claim for duties or taxes unless he should submit to the jurisdiction of the United States and make adequate provisions to secure the payment of the claim after adjudication.

This provision of the Bill, which is now pending in the Senate Finance Committee, has been objected to by the Secretary of State on the ground that if enacted it will be availed of by foreign governments as a pretext for retaliatory restrictions against the United States. It has likewise been objected to by the Government of the Dominion of Canada on the ground that it would seriously restrict the importation of whisky of Canadian manufacture into the United States and would,

therefore, nullify the reduction in the duty on whisky from $5.00 to $2.50 a proof gallon as contained in the Trade Agreement between Canada and the United States which was executed November 15, 1935, and became effective January 1, 1936.

It is a fact that the provision referred to is directed mainly at the Canadian companies which during the period of Prohibition were responsible for the manufacture of a substantial portion of the distilled spirits illicitly sold in the United States. These companies or their successors now have warehoused in Canada huge stocks of American-type whisky -- rye and bourbon -- produced in the Prohibition period for which their only market is the United States; and it is these companies or their successors which are responsible for the present attitude of the Canadian Government in opposing this legislation. It is believed to be a fact also that it is the opposition of the Canadian Government which in the last analysis is responsible for the attitude of the State Department with respect to the legislation.

It will be helpful, if not in fact necessary, to an understanding of the proposal made by the Treasury Department and now pending in the Senate Finance Committee to have at least some familiarity with the part played by the Canadian distillers in supplying the bootleg-whisky market in the United States in the years from 1919, when the National Prohibition laws became effective, until 1933, when they were repealed as a result of the adoption of the Twenty-First Amendment.

Liquor Smuggling from Canada during the Prohibition Period

Although the bulk of the "bootleg" liquor consumed in the United States during the Prohibition period was the product of illicit distilleries located in the United States, as evidenced by the fact that thousands of such plants were confiscated by the Government in that period, yet large-scale liquor smuggling operations were carried on continuously both over the land borders and from vessels hovering at sea. The sources of contraband liquor included countries in Europe and Central America, but the bulk of the smuggled liquor came from Canada, in whose distilleries it was produced and in whose warehouses it was matured for the sole purpose of exportation to the United States in violation of the Customs and Revenue laws, as well as the National Prohibition laws. It is estimated that not less than 22,000,000 gallons of whisky, to be conservative, (not to mention beer, ale, gin and wine) were brought into the United States from Canada in the period from 1919 to 1933.

Prior to 1919 the distilling industry in Canada was unimportant. The Canadian demand for liquor has run toward rum and Scotch whisky, and this demand has always been supplied by imports from the West Indies and the British Isles. With the advent of Prohibition in the United States new distilleries were established in Canada and old plants were renovated and enlarged for the manufacture of American-type whiskies. Canadian government statistics show five distilleries in operation in

1919 and twenty-one in 1933. During the early days of Prohibition the Canadian activities were comparatively scattered and unorganized. Most of the liquor was raw, and it was commonly bottled with counterfeit United States revenue stamps and forged labels. Smuggling was carried on by various small enterprisers. Gradually, however, the distilling and smuggling interests were consolidated and there finally developed a number of powerful companies and syndicates, the most notorious of which were the Bronfman family, operating various firms and having wide interests, such as Distillers Corporation, Seagrams, Northern Export Co., and United Distillers; Hatch and associates, controlling Hiram Walker and Gooderham & Worts; the Reifels, on the Pacific Coast, controlling British Columbia Distillery; Melchers; Consolidated Distillers, a subsidiary of Canadian Industrial Alcohol; and Consolidated Exporters and Dominion Factors, which were in the nature of cartels.

It was the common practice of the Canadian companies to employ experienced personnel from the United States. They purchased American machinery, and appropriated American brand names, and, as has been seen, particularly in the early stages of their operations while their newly manufactured stocks were maturing, there was considerable traffic involving the use of fraudulent labels in imitation of famous American brands and not infrequently the use of counterfeit United States revenue stamps.

The Canadian companies had the sternest kind of competition from the American syndicates which dealt in liquor produced illicitly in the United States; and to meet this competition and provide a ready sale for their merchandise in this country it was their practice, operating singly or in pools or groups, to maintain selling agents and salesmen in the United States. Especially after 1930, they established or gained control of warehouses at such points as St. Pierre et Miquelon, and Belize to facilitate the smuggling of their liquor upon our coasts. They financed the operations of American gangs or mobs which handled their merchandise. They were in constant communication by telephone, telegraph or radio with their American agents and customers, and by every available means, and with complete ruthlessness, they sought to broaden and extend the scope of their illicit market in the United States.

Attitude of the Canadian Government toward Liquor Smuggling

For more than ten years after the adoption of the Prohibition Amendment the Government of the Dominion of Canada stood in a passive or negative attitude with respect to the violation of the American Prohibition laws by their nationals. Apparently the attitude of the Dominion Government was that these laws were not supported by American public opinion, that they were being violated with comparative impunity within the boundaries of the United States, and that there was nothing

in the situation which demanded of Canada anything in the nature of a vigorous attempt to embargo the exportation of the product of Canadian distilleries which the Government was, of course, aware was destined entirely for the American market. The theory seems to have prevailed at Ottawa throughout the Prohibition period that the Canadian operations were technically within the law — the Canadian law — and it is undoubtedly true that every conceivable stratagem and device was employed by the Canadian companies to give the color of legality to their transactions. The Canadian Government was loath to discourage growing domestic industry, even though it was built on smuggling, was surrounded by corruption, and was even frequently accomplished by violation of Canadian laws; for they did not hesitate to violate their own country's laws when that could be done with profit.

However this may be, it was not until 1925 that the Canadian Government was impelled to take any action toward cooperating with the United States in an endeavor to curb the smuggling traffic. In that year a treaty was negotiated between the two governments by the terms of which Canada undertook to require that notice should be given to American Customs officers of all prospective shipments or consignments of liquor from points in Canada to points in the United States. In exchange the United States permitted Canadian liquor to reach the Yukon territory through Alaska, and made other valuable concessions to the Canadians. While this action showed an awakened interest in the subject

on the part of Canada it was of little effect in reducing the volume of the smuggling traffic. This was for the reason that notices of shipment or consignment were ordinarily, in the nature of things, received by American Customs officers too late to permit of preventive measures. In those days most of the illicit traffic was across the border, being centered chiefly on the Detroit River where vessel movements required but little time and could readily be completed prior to the receipt of notice by American enforcement officers. It is not too much to say that the 1925 Treaty accomplished nothing of benefit to the United States.

No further steps of consequence were taken by the Canadian authorities until 1930 when legislation was enacted by the Canadian Parliament prohibiting clearance of liquor destined for delivery in the United States. On its face this legislation seemed to provide a satisfactory weapon to prevent the smuggling of Canadian liquor into the United States, but, as a matter of fact, it did no more than bring about a change in the methods used by the Canadian companies to get their merchandise into the American market. Whereas previously the practice had been for these companies to ship their liquor directly to the United States either over the border or by vessel, the companies were now compelled to make shipment to intermediate ports like St. Pierre and Belize, and to carry on the smuggling operations from these

ports instead of directly from Canada as before. This arrangement undoubtedly put an end to the large scale smuggling operations over the land and water boundaries between Canada and the United States but it did not have the slightest effect in diminishing the aggregate volume of smuggling. In one sense the arrangement was of decided advantage to the Canadian companies. It exempted them from the further payment of the Canadian excise tax, which at the time amounted to $7.00 per proof gallon, an amount which certainly was adequate to compensate for the added cost of the operation via St. Pierre and Belize and other similar intermediate ports. For by proving by consular certificate landing of the liquor at these ports they became entitled to a refund of the internal revenue taxes paid upon withdrawal of the liquor from warehouse. They had, naturally, been unable to obtain such certificates for direct landings in the United States.

Without intending to reflect in the slightest upon the motives which inspired the Dominion Government to take its belated action to restrain its nationals from their open and notorious violations of the American Prohibition laws, it should be said that during the entire period between the enactment of the American Prohibition laws and the adoption of the law of 1930 there had gradually grown up in Canada a sentiment of hostility to the operations of the Canadian companies in violation of the laws of the United States. There were influential groups in Canada which insisted that the Canadian Government was

conniving in breaking the laws of the United States and that by its hands-off policy it was fostering conditions which would ultimately become dangerous to the Dominion itself. The scandalous conditions which were allowed to exist in Canada during the first years of Prohibition in the United States were more than once made the subject of investigations by the Dominion Government and it is probably true to say that it was rather a revulsion of feeling among the better elements of the Canadian population against a system which was fostering crime in a friendly and neighboring country, bringing the good name of Canada into disrepute, and endangering its relations with the United States, than a desire on the part of the Canadian Government to aid the United States in dealing with its purely domestic problems, which was responsible for the action taken by the Canadians in 1930. Under all the circumstances, something can be said for the proposition that the United States has greater cause for resentment at the long continued indifference of the Canadian Government than for gratification at the belated action taken in 1930.

The Situation at the Time of the Repeal of the Prohibition Amendment

The smuggling of Canadian liquor in the United States continued without abatement until the repeal of the Prohibition Amendment in December, 1933. At that time the wheels of the legitimate American distilling industry, which except for the manufacture of medicinal liquor

had remained stationary since 1918, began to move again with a view to supplying the demand of the American market for beverage spirits. The Federal Alcohol Control Administration was established, under the joint auspices of the National Recovery Administration and the Agricultural Adjustment Administration.

The F.A.C.A. set up a permit system for distilleries and importers, allocating production quotas to the former and, for a while, import quotas to the latter. Prominent among those who sought and obtained permits were a number of affiliates or subsidiaries of the Canadian bootleg interests, especially Seagrams and Hiram Walker. The usual rule of the F.A.C.A. was to grant permits as a matter of course where there was no evidence of an actual conviction of a crime on the part of the applicant or its backers. Inasmuch as the Canadian bootleggers had succeeded in remaining outside the United States there was no record of conviction against them. Hiram Walker proceeded to build the largest distillery in the world while Seagrams bought up, renovated and enlarged certain existing plants. They have become powerful in the American distilling business. In December, 1935, Seagrams produced in the United States about 8 percent of the total whisky production and close to 10 percent of the total distilled gin production for the month, and was responsible for over 4 percent of the country's whisky withdrawals for consumption, and almost 9 percent of its gin withdrawals for consumption. In actual sales in the United

States this company for a while led all competitors. Hiram Walker showed over 10 percent of the total whisky production and 25 percent of the total distilled gin production of the country for December, 1935; its whisky withdrawals for December, 1935, were about 10 percent of the total for the country and its gin withdrawals over 22 percent, and in its distillery in Peoria it possesses at the present time over 10 percent of the total producing capacity for the United States.

The activities of the Canadian distillers since Repeal may be divided into two classes: first, those involving a liquidation of the Canadian whisky stocks, and second, those involving a re-establishment of business in the United States. All their whisky stocks in Canada must inevitably be brought into the United States. To facilitate this they have always entertained the hope, finally realized, that the $5.00 duty would be reduced. Several of the Canadian concerns have been disposing of their whisky stocks by sales to American interests while the others — perhaps controlling the greater portion of Canadian whisky stocks — have simply brought their stocks over the border to their own warehouses in this country.

This, therefore, was the picture which became clearer to this Administration as it turned toward a handling of the liquor question in terms of revenue instead of prohibition. It became clearer and clearer that the Canadian companies, which had been able to escape

punishment for violation of the laws against smuggling — not to mention the Prohibition laws — and to evade payment of taxes, including income taxes as well as Customs and excise taxes, were now either establishing themselves with impunity in the United States or were, without establishing themselves in business in the United States, disposing of their assets in the markets of the United States without regard to their obligations to this Government. In addition to the enormous difficulty of obtaining facts with which to prove its claims, the Government was faced with the problem of obtaining jurisdiction over the defendants who were present in the United States, if at all, only through complicated legal aliases of affiliated and subsidiary corporations, and of making sure that if judgment should be obtained after the delays incident to litigation there would be assets in the United States out of which the claims could be collected. Merely obtaining a judgment in the courts of the United States would not be sufficient because even should there still by that time be assets remaining in Canada belonging to these defendants the courts of Canada would not aid the United States in the satisfaction of the judgment out of assets in Canada. Nor, of course, would the courts of Canada entertain an action in the first instance to collect these claims.

It was these circumstances that gave rise to the proposal for some sort of remedy that would assure this Government that any Canadian who wished to do business or to sell liquor in the United States,

directly or indirectly, would, first, submit to the courts of the United States to try the merits of the Government's claims, and, second, give adequate security that the assets brought into the United States, in the form of the whisky stocks for which the United States is the only market, should not be dissipated in fraud of the Government's claims.

Genesis of the Present Proposal to Require Submission to Jurisdiction and Security

The first case brought by this Administration for the collection of the Canadian claims was against the British Columbia Distillery and its operators, the Reifels, of Vancouver. The suit was for $17,000,000 and the evidence available was quite strong. Nevertheless the Government ultimately was obliged to accept an offer of settlement which involved a total payment of only $700,000, of which $200,000 was the amount of the bond forfeited by two of the Reifels who had been apprehended in the United States on criminal charges and who had jumped their bail. The Reifels had no liquor in their own name in the United States nor any other substantial assets that could be made subject to execution. They did, however, have large stocks of whisky in Canada which they kept selling f.o.b. Vancouver, payment in Vancouver, to American associates. The Government made great efforts to reach either the liquor that was being sold or the proceeds that were being remitted but although it was obvious that this method of marketing the liquor had been devised for

the purpose of defeating attachments or seizures by the Government, it was compelled to stand by and see the liquor enter the United States and the proceeds of sale removed from the United States without either being available for the satisfaction of its claim. Had legislation of the sort that is now being proposed been then available, the Government need never have compromised the action for the nominal amount which was accepted in that case, and which represented no more than the nuisance value of the litigation to the defendants.

With this lesson learned, the Department of Justice and the Treasury, with the cooperation of the F.A.C.A., arranged to set up an F.A.C.A. regulation whereby the liquor of these Canadians would be denied entry into the United States in any case where a criminal or civil proceeding was pending on account of prior smuggling, unless there was a submission to jurisdiction and a provision for security. At that time the Treasury and the Department of Justice both conferred with the State Department, to obtain from the State Department a clearance for the proposed regulation. The facts were fully explained and on that basis the State Department, in a letter from Assistant Secretary of State Moore addressed to Mr. Whitaker of the Department of Justice, stated that it would interpose no objection to such steps even though it entertained some doubt as to the general advisability of the proposed restriction. The letter is as follows:

ASSISTANT SECRETARY OF STATE
Washington

April 29, 1935

Dear Mr. Whitaker:

Referring to our conversation last Friday afternoon, relative to the suggested adoption of a regulation under existing law which would prohibit importations by a manufacturer who refuses to submit himself to the jurisdiction of the courts of the United States in criminal or civil proceedings instituted against him concerning a claim based upon an alleged violation of our custom laws, I am writing this after having brought the matter to the Secretary's attention. It is at least conceivable that the effect of such a regulation, for which there seems to be no precedent, might invite retaliatory action by other governments, or interfere with tariff negotiations now in progress, and furthermore might cause the Canadian Government to recede from its agreement touching the release of liquor from bonded warehouses destined for the United States. Nevertheless, since it appears that the Department of Justice and the Treasury Department unite in favoring the adoption of such a regulation, this Department is unwilling to take the position of opposing its adoption. Accordingly, the other Departments mentioned must feel free to act, but it is hoped and expected that this Department will be advised of any protest or incident pertaining to the regulation that may raise a question of policy affecting our international relations.

Yours very sincerely,

(Sgd) R. Walton Moore
Assistant Secretary
of State.

Mr. S. E. Whitaker
Department of Justice
Washington, D. C.

The arrangement with the F.A.C.A. for such a regulation was frustrated by the decision of the Supreme Court in the Schechter Case. Inasmuch as F.A.C.A. rested for its validity on the constitutionality of the N.R.A. legislation the decision in the Schechter Case destroyed the possibility of a regulation such as was proposed.

It therefore became necessary to consider legislation to the same effect.

Acting upon the clearance from the State Department, and with the sanction of the Department of Justice, the Treasury proposed Section 403 in its Omnibus Liquor Bill. That section was unanimously adopted by the House and it was in fact before the Senate for consideration when the Treasury was first informed of the proposal to reduce the duty on liquor from $5.00 to $2.50 per gallon in the Canadian Trade Agreement.

The Relationship of the Proposal to the Canadian Trade Agreement

On November 9, 1935, the State Department presented to the Treasury a draft of a proposed trade agreement with Canada and sought to induce the Secretary of the Treasury to advise the President that the Treasury would not object to the reduction in the tariff on whisky, which was to be one of the major provisions of the Agreement. The Secretary informed the State Department's representative, Mr. Hickerson, that before he would approve the reduction in the tariff on whisky he would require assurance that the proposed concession would be understood as having no effect on the prosecution of the claims which the Treasury Department had, amounting to millions of dollars, against Canadian liquor distillers for Customs duties and Internal Revenue taxes. Mr. Hickerson stated that the State Department had had these claims in mind

and that it did not see how the trade agreement would affect in any way the Treasury's efforts to prosecute these claims. The Secretary of the Treasury likewise mentioned this reservation in a telephone conversation with the President.

On Sunday, November 10, 1935, a written statement was prepared in the Treasury expressing the understanding of this Government that after the consummation of the trade agreement the Canadian Government would cooperate with this Government's prosecution of the proposed litigation against the Canadian distillers to the extent of making records and other information available to the United States, as provided by existing treaty, and that the objective of the pending legislation (that is, H.R. 9185) affecting the right to import products of Canadian distillers involved in such litigation would not be considered inconsistent with the Agreement.

The next day Mr. Oliphant, General Counsel of the Treasury Department, communicated this statement to Mr. Hickerson by telephone and received his assurances that the communication of this statement to the Canadians was all that was necessary to assure the Treasury Department that its position was being safeguarded. Following this conversation the statement was transmitted by Mr. Oliphant to the Secretary of the Treasury, who in turn transmitted it with a covering letter to the Secretary of State. The documents are as follows:

November 11, 1935

Dear Mr. Secretary:

I attach the text of the statement which Mr. Oliphant read to Mr. Hickerson over the telephone, this morning, of the Treasury Department's conclusion following the examination of the question of reduction of the duty on certain Canadian whiskies.

Very truly yours,

(Sgd) Henry Morgenthau, Jr.

The Honorable

The Secretary of State

Enclosure

(Enclosure)

It is not apparent that there could be any legal effect upon pending cases against Canadian distillers resulting from the proposed trade agreement with Canada. The possibility, however, exists that from a negotiating, diplomatic or psychological standpoint, the Canadians may feel that the consummation of the agreement will be an indication of the abandonment on the part of the United States of its intention further to press these cases. To avoid this, it is suggested that the United States make it clear, at the time the agreement is signed, that it, of course, assumes that the Canadian Government will cooperate in such cases 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 the Canadian distillers involved in such cases is not to be considered inconsistent with the agreement.

On Thursday, November 14, 1935, Mr. Hickerson advised Mr. Oliphant that the statement had been shown to the proper representatives of the Canadian Government, that these representatives had accepted the statement without question and that nothing further was required as assurance

that the consummation of the Trade Agreement would not in any way interfere with the course of action which this Government proposed to follow with regard to Canadian distillers, as indicated in the written statement.

Since that time it has appeared that the statement prepared in the Treasury was in fact read by representatives of the State Department to the Canadian representatives.

Thereafter, on November 15, the Agreement was formally signed.

Under these circumstances it cannot be said that the Canadian officials were not fully informed as to this Government's position with regard to the prosecution of its claims, nor can it be said that the reductions in the whisky tariff provided for in the Trade Agreement were not made with the understanding that this Government's present action as expressed in the legislation contained in H.R. 9185 would be pursued. Indeed, officials of the Canadian Government had been in communication with officials of the Treasury Department even prior to the proposal for an F.A.C.A. regulation on the question of permitting Treasury agents to examine certain Canadian customs documents which would be of evidentiary value in the prosecution of these claims. The distillers, who were instrumental in securing the reduction of duty, were of course at all times fully aware of these circumstances.

Having got the Trade Agreement signed, cutting the whisky duties in half, the Canadian distillers have apparently entered into a plan to kill the proposed legislation by threats of retaliation by the Canadian Government. While the Treasury officials were conferring with the State Department officials with a view to considering changes in the proposed legislation that would meet the State Department's objections, it was learned that the Trade Agreement was being debated on the floor of the Canadian Parliament and that reference was made to the subject by certain Canadian ministers and members of Parliament. The coincidence apparently had the effect of causing the State Department to insist that no legislation whatever would be satisfactory to them, in spite of the fact that the Treasury had expressed a willingness to adopt those of the State Department's proposals to which, it had been indicated, the Canadian representatives had expressed their willingness to accede.

An examination of the verbatim transcript of the discussion in Parliament indicates that certain members, undoubtedly at the instance of the distillers, contended that the proposed legislation together with certain regulations proposed by the F.A.A. with regard to the labeling of liquor, would "nullify the benefits" of the reduction in the tariff on whisky. The Minister for Trade and Commerce is reported to have said in the debate, "These two matters are not mentioned in the Agreement at all. They have developed since the Agreement was signed."

But he soon corrected himself, "Perhaps I should correct that; they have come into more active discussion since the Agreement was signed." The Prime Minister, Mr. Mackenzie King, entered the debate. The following from the official report is illuminating:

"Mr. Mackenzie King: I should like to add just a word in reference to what the Minister has said as to this matter assuming a new importance since the Agreement has come into effect. As my Honorable friend apparently knows it is a very old issue. It is not something which has come into being just recently; it is a matter which has been under consideration by Department of the United States Government for some considerable time.

"Mr. Cahan: I know of the fact that the previous Government was aware to a certain extent of the difficulties which had arisen when this bill, of which I read one section, was introduced in the House of Representatives, and a great many people were, I think hopeful that in the course of the negotiations between the present Government and the United States Government some understanding might have been reached with regard to the final enactment of that measure.

"Mr. Mackenzie King: I think my Honorable friend will find that the representations the Government have made will be helpful towards that end.

"Mr. Douglas: I would like to ask the Minister whether the Government were aware at the time this agreement was signed that this legislation was passing through the House of Representatives, or had passed last August?

"Mr. Euler: It is not through the Senate.

"Mr. Douglas: But through the House of Representatives?

"Mr. Euler: Yes.

"Mr. Douglas: Would it not have been possible to provide in the new Agreement some item that would have prevented this embargo?

"Mr. Euler: The Government of Canada cannot very well interfere in the domestic affairs of the United States. They have complete authority to do as they please. This Agreement was not subject to ratification; the President had complete power.

"Mr. Douglas: I was not suggesting that. I was asking if it would not have been possible to have in the Canada-United States Agreement some clause which would have prevented this item from being nullified by the legislation pending.

"Mr. Mackenzie King: Perhaps I might point out to my honorable friend that there is an article in the Agreement, Article XI, which is intended to meet the sort of contingency that he and possibly others may have in mind. Article XI reads:

> "'In the event that the Government of either country adopts any measure which, even though it does not conflict with the terms of this Agreement, is considered by the Government of the other country to have the effect of nullifying or impairing any object of the Agreement, the Government which has adopted any such measure shall consider such representations and proposals as the other Government may make with a view to effecting a mutually satisfactory adjustment of the matter.'

"That provision has been inserted to avoid the possibility of occurances of the kind my honorable friend has mentioned. Of course, as the Minister has just said, it is not within the province of one country to interfere in the domestic affairs of another country, and it is not for the Government of Canada to tell either the House of Representatives or the Senate of the United States what they should or should not do. Nothing of that kind could appear in any agreement; it would not be permitted to appear. But I can assure my honorable friend that with respect to this matter, as far as it affects Canadian interests, the position and the interests of Canada have been most fully represented at Washington. I have every reason to believe that such representations are being sympathetically considered, though what final action may be taken by any legislative body in the United States it is, of course impossible to say.

"Sir George Perley: I am glad to hear what the Prime Minister has just said on this subject. I only want to ask now, since I understand that there is in the agreement a provision for negotiation if a clause of the Agreement is completely nullified by some other legislation, whether in case such negotiations should not be successful that would give Canada the right to terminate the Agreement. This is a serious matter.

"Mr. Mackenzie King: If any essential feature of the Agreement were impaired by some action of the United States, I should feel that, under the escape clauses there would be opportunity for the Dominion to go the length, if need be, of rescinding the Agreement after having made the proper representations."

The item under discussion, namely, the provision of the Trade Agreement referring to the reduction of the duty on whisky, was thereupon agreed to.

It will be seen, therefore, not only that the proposed legislation does not invalidate the Trade Agreement but that both parties understood that the proposed legislation would be prosecuted in spite of the Trade Agreement. Moreover, there is a provision in the Trade Agreement which specifically excepts police and revenue measures. The proposed legislation is plainly and incontestably a revenue measure and neither the State Department nor the Canadian Government has contended otherwise.

Objective of the Proposed Legislation

In proposing Section 403 of the Omnibus Liquor Bill, H.R. 9185, the Treasury sought simply to obtain a remedy to enable it to litigate in the courts of this country its large claims for Customs duties and Internal Revenue taxes against a class of persons who for years had evaded the jurisdiction of the courts of this country and who were now enjoying the benefits of our markets to do business and dissipating assets that might be available for the payment of our claims, and in

some cases were operating through affiliates under Government license in this country. In claims against residents of this country the Government has for years had the power of jeopardy assessment, distraint and other summary remedies by which the taxpayer first pays and then sues to recover back his payment if he can establish that the money was not due. This legal power, now available against residents of the United States, exists precisely in order to guard against a dissipation of assets that might otherwise take place if the Government had the burden of suing first. In the case of these nonresidents, however, a complete lack of equality exists. The proposed legislation sought in a small measure to remove the inequality, not by providing for any forfeiture of merchandise or any complete embargo but only by doing what this Government could undoubtedly do under our Constitution, and what was fair and reasonable, namely, by announcing to these persons that if they did not submit to the jurisdiction of the courts of this country and provide adequate security against the alienation of their assets in fraud of our claims, pending litigation, they would not be permitted to dispose of their goods in our markets or otherwise, directly or indirectly, do business under the protection of this Government.

The House unanimously passed the bill without any protest from the State Department or the Canadian Government. It was only later, after the Trade Agreement was signed, that protests began. Objection was raised on the ground of harshness and the like. The Treasury

Department has proposed to the Senate Finance Committee a number of changes in the House bill which would remove every possible legitimate objection without destroying the principle of the bill, even at the risk of to some extent jeopardizing the protection which might have been obtained by the original proposal as adopted by the House of Representatives. Thus the Treasury has announced its willingness to remove every feature of retroactivity in the bill (except, of course, the one desired by the Canadians, that is, that the bill should not apply to this Government's existing claims against them). In doing this the Treasury is taking the risk of having to face alienation of assets prior to the effective date of the act in fraud of this Government's claims. In order to give the defendants an absolute right to compel the Secretary to admit the entry of their merchandise language was inserted in the House bill providing for the tendering of a bond in double the amount of the claim. Although this double indemnity feature is common to similar legislation, the amount being usual in order to take care of increased claims, additional expenses, etc., the Treasury agreed, first, to a reduction in the bond to the amount of the claim, and second, as an alternative, to permit a lien to be given in the same amount on property in the United States. It has now agreed also to a suggestion made by the State Department that there be required only a deposit, or a bond, to cover liquor currently brought into the United States, up to the amount of the claim.

Under these modifications every plausible objection to the legislation is removed. Should they be adopted the Canadians would still be treated with much more gentleness than any American taxpayer similarly indebted to the Federal Government. Nevertheless the Canadian representatives, at the instance of the Canadian distillers, continue to insist to the State Department that the entire proposal must be dropped.

It may be pointed out that whatever the situation was prior to repeal when there was a large distilling industry in Canada, that situation no longer exists. Today there is no legitimate Canadian distilling industry. The Canadian distillers have already liquidated or are liquidating their businesses. They no longer manufacture, since it is more profitable for them to do their manufacturing in the United States. Their sole stake in Canada today is the 35,000,000 gallons of aged whisky in warehouse and the only employment of Canadian labor in connection with it is the employment incident to the safekeeping of such whisky in the warehouses. The Canadians have waited for the Trade Agreement to reduce the tariff duty by half so that they might ship this whisky into the United States to be used by them chiefly in blending with spirits of United States manufacture. Hence, the Canadian Government in championing the cause of these distillers is acting for the interest of no more than a few concerns who are only technically Canadian, who no longer represent a real Canadian industry, whose

affiliations and interests are all centered in the United States, and whose present activities are of no important concern to the Canadian people.

ACTION TAKEN BY THE TREASURY DEPARTMENT SINCE REPEAL IN ENFORCEMENT OF LIQUOR LAWS

1. Establishment of improved system of supervision over the licensed production and sale of intoxicating beverages and industrial alcohol, including - - -

   (a) The prohibition of sales of spirits in bulk containers
   (b) The control of the manufacture, sale and use of liquor bottles.
   (c) The use of numbered strip stamps.
   (d) The control of the bottling of spirits.
   (e) The maintenance of controls over imports.
   (f) The continuous surveillance of rectifying plants.
   (g) The installation of beer meters at breweries.
   (h) The periodical inspection of retail outlets.

2. Inauguration of additional enforcement methods, including - - -

   (a) Control of the distribution of materials used in the manufacture of spirits.
   (b) Better control over denatured alcohol.

3. Application of more effective preventive measures against smuggling, including - - -

   (a) International cooperation to close smuggling bases, and to secure current information regarding sources of supply and shipments of contraband from foreign ports.
   (b) Coordination of all Treasury enforcement agencies in a concerted drive to eliminate cnntraband operations between ports of entry.

RESULTS

1. Virtually all leaks have been stopped in the legitimate industry.

2. Illicit domestic production and sale is steadily diminishing.

3. Smuggling is practically at an end.

4. Revenues are increasing, and the tax-paid consumption of spirits is now at about the pre-Prohibition level.

PART TWO

LIQUOR CONTROL IN THE TREASURY DEPARTMENT.

LIQUOR CONTROL IN THE TREASURY DEPARTMENT

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LIQUOR CONTROL IN THE TREASURY DEPARTMENT

At the time of the repeal of the Prohibition Amendment there were two Federal agencies having to do with the enforcement of the laws relating to alcoholic beverages. The Bureau of Industrial Alcohol of the Treasury Department was charged with the duty of supervising the production and distribution of beer under the provisions of the so-called "Beer Law" which was enacted in March, 1933. It also supervised the production and distribution of distilled spirits for medicinal uses under the National Prohibition Act, and of alcohol for industrial pruposes. The Alcoholic Beverage Unit of the Department of Justice was the successor agency to the Bureau of Prohibition, which had been abolished by the Executive Order of June 10, 1933. This Unit was charged with the responsibility for the suppression of the illicit traffic in intoxicating beverages.

Following the repeal of the Prohibition Amendment it was determined to concentrate the responsibility for all phases of liquor law enforcement in the Bureau of Internal Revenue, and on March 10, 1934, the President, by Executive Order, transferred all the functions which were then being exercised by the Bureau of Industrial Alcohol and the Alcoholic Beverage Unit to the Bureau of Internal Revenue. This Executive Order became effective on May 10, 1934, and on that date the Secretary of the Treasury, by Treasury Decision, created in the Bureau of Internal Revenue a special division under the name "Alcohol Tax Unit" to perform these functions.

In the period between the repeal of the Prohibition Amendment and the establishment of the Alcohol Tax Unit on May 10, 1934, the Bureau of Industrial Alcohol, then operating under the supervision of the Commissioner of Internal Revenue, undertook to supplement the work of the Alcoholic Beverage Unit of the Department of Justice in the suppression of the illicit liquor traffic by the assignment of its own personnel for this purpose. Approximately 700 field agents were employed on such work in the Bureau of Industrial Alcohol on the date of the establishment of the Alcohol Tax Unit. Meantime, the force of agents employed by the Alcoholic Beverage Unit of the Department of Justice, which, on June 30, 1933, consisted of approximately 3100 employees, had been substantially diminished by reason of reduced appropriations, and numbered only 639 when that agency was transferred to the Bureau of Internal Revenue under the provisions of the Executive Order of March 10, 1934. When the Alcohol Tax Unit was established on May 10, 1934, the combined strength of the personnel assigned to the suppression of the illicit traffic in intoxicating beverages was less than 1400, and the force has been maintained at approximately this strength up to the present time.

The Alcohol Tax Unit

The Alcohol Tax Unit consists of two branches. The Permissive Branch is charged with the supervision of the legitimate industry which is engaged in the production and distribution of

alcoholic beverages, as well as producers, distributors, and users of alcohol for industrial purposes, with the two-fold object of insuring the collection of Federal taxes and preventing the unlawful diversion of industrial alcohol for beverage purposes. The following are the principal classes of persons coming under the supervision of the Permissive Branch: Distillers; rectifiers; brewers; winemakers; wholesale and retail liquor dealers in distilled spirits, wines, and fermented malt liquors; industrial alcohol manufacturers and denaturers; hospitals using tax-free alcohol; and persons using denatured alcohol for commercial or industrial purposes.

At the present time approximately 2300 employees are required in the performance of these supervisory functions, including 1300 storekeeper-gaugers stationed at distilleries, warehouses, and rectifying plants, 400 inspectors whose duty it is to make periodical inspections of the plants and places of business of persons of the above-enumerated classes, and several hundred auditors and clerks whose principal function is the issuance of permits and the examination of reports and returns.

The Enforcement Branch of the Alcohol Tax Unit is charged with the duty of preventing, detecting, investigating, and prosecuting violations of the internal revenue laws relating to intoxicating beverages. The personnel of this branch now consists of about 1400 field agents, called "Investigators". They search out and seize

illicit distilleries, cooperate with Customs officers in the prevention and detection of liquor smuggling, apprehend illicit distillers, transporters, and bootleggers, and make investigations necessary to the successful prosecution of offenders of these classes, including persons financially interested in any phase of the illicit traffic.

For the purposes of the administration of the Alcohol Tax Unit, the country is divided into fifteen field districts, each in charge of an officer known as the "District Supervisor". In each district the organization is divided between the Permissive and Enforcement Branches, as above outlined, each branch being in direct charge of an officer known as "Assistant District Supervisor".

SUPERVISION OF THE LEGITIMATE INDUSTRY

Marked progress has been made in the last two years in all phases of the work of supervising licensed manufacturers and distributors of alcoholic beverages and users of industrial alcohol, with a view to preventing tax evasion. Some outstanding examples of this are given below:

Evidentiary Strip Stamps

The Liquor Taxing Act of 1934, enacted in January, 1934, provided that all distilled spirits sold in bottles at retail should carry a special stamp as evidence of taxpayment. At first there was considerable laxness in the distribution and use of such stamps and

there is no doubt but that the so-called red strip stamps in repeated instances found their way into the hands of illicit operators who were thus enabled to dispose of bootleg liquor as being legitimate. To meet this situation, the Department provided for the serial numbering of such stamps, for their registration at the time of sale by Collectors of Internal Revenue in the name of the distiller, rectifier, or importer to whom sold, and for their delivery by registered mail to the Government officers in charge of the bottling plants. These and other similar requirements have fully succeeded in safeguarding the distribution of red strip stamps against any possibility of fraud, so that today these stamps when found on containers in retail stores are a positive guarantee of taxpayment. A recent investigation made by the Chief of the Secret Service, involving the examination of large stocks of liquor in the hands of retail dealers in various cities in different parts of the country, disclosed no single instance of counterfeit stamps or stamps irregularly procured.

Bulk Sales

By the provisions of the distillers' and rectifiers' codes which were in effect during the life of the Federal Alcohol Control Administration, the sale of beverage spirits in bulk was forbidden. This had the effect of limiting the form in which wholesale and

retail dealers could procure their merchandise to liquor put up in bottles and cases, and bearing the evidentiary strip stamps. With the termination of the codes in May, 1935, as the result of the Schechter decision, the Treasury Department, by regulation, temporarily continued the prohibition against bulk sales; and, in August, 1935, Congress made this prohibition permanent by the enactment of appropriate legislation. The requirement that all wholesale and retail liquor dealers must procure their spirits in bottled form is of inestimable value in preventing frauds on the revenue. Coupled with other enforcement measures, such as the requirement concerning strip stamps which has been referred to above, the periodical inspection of the places of business of retail dealers, and the control of the manufacturers of liquor bottles, it has played an important part in the virtual elimination of the sale of illicit spirits through licensed outlets.

Liquor-Bottle Control

In July, 1934, under authority contained in an Act of Congress approved June 18, 1934, the Department issued regulations governing the manufacture, distribution and use of containers for distilled spirits to be sold at retail. Under these regulations only persons licensed by the Commissioner of Internal Revenue are permitted to engage in the manufacture of liquor bottles, and the regulations require, with certain minor exceptions, that all liquor bottles must

be blown with the license number of the bottle manufacturer, the license number of the distiller or rectifier bottling the spirits (or, in the case of imported spirits, the name of the manufacturer, exporter or importer), and a warning against the sale or reuse of the bottle after it is emptied of its original content. The regulations require the manufacturers of liquor bottles, as well as all distillers and rectifiers authorized to package spirits for retail sale, to report to the Commissioner of Internal Revenue all bottle orders, and all shipments and receipts. These regulations set up a system which has worked satisfactorily to prevent illicit cutting plants from engaging in the operation, which was so common in the Prohibition period, of packaging bootleg or smuggled liquor in such a way as to simulate the tax-paid product.

Brewery Meters

On March 1, 1935, pursuant to a provision of law enacted in 1919, the Department required the installation of meters in all breweries for the purpose of securing the more accurate measurement, for tax purposes, of fermented malt liquors withdrawn from brewery premises for sale. The use of these meters has proven entirely satisfactory both to the industry and to the Department. They have not only simplified the task of brewery supervision by revenue officers and resulted in a substantial economy to the Government, but they have made possible a more thorough check against tax evasion and fraud.

Supervision of Rectifying Plants

With the repeal of the Prohibition Amendment there sprang up in all parts of the country a large number of manufacturers known as rectifiers, whose operations consist of the simple bottling of straight spirits under local brand names, and the manufacture of whiskey blends, gin, and such specialties as cordials, liqueurs and mixed drinks. For a considerable period rectifiers were permitted to carry on their operations, as had been done prior to Prohibition, virtually without supervision on the part of the Bureau of Internal Revenue, and there is little doubt but that in this period rectifying plants were the source of supply for substantial quantities of illicit spirits. To remedy this condition the Department placed all such plants under a system of inspection in June, 1934, and on September 1, 1934, prescribed, by regulation, that rectifying and bottling operations could be conducted only under the supervision and in the presence of Government officers. Under these regulations rectifying plants were placed under somewhat the same system of supervision as has always prevailed at distilleries, thus eliminating all danger of the further use of such plants as outlets for illicit spirits.

Bottling of Distilled Spirits

Inasmuch as, under the regulations above referred to, spirits for retail sale can be packaged only in bottles, the Bureau of Internal Revenue has concentrated attention upon all bottling operations,

whether done by rectifiers, distillers or warehousemen. Its regulations now provide that no spirits may be bottled by any person except those of the three classes named, and, with minor exceptions, they provide also that all spirits must be bottled under the supervision and in the presence of Government officers, and only after verification by such officers of the taxpayment of the spirits proposed to be bottled. It perhaps should be remarked here that in the period before Prohibition spirits could be bottled for sale not only by distillers and rectifiers but by all wholesale and retail dealers, of whom there were, of course, many thousands. Under the present restrictions the total number of concerns authorized to bottle spirits for retail sale is approximately 700. The present system gives the Government an economical and effective control over all sources of supply of lawfully produced spirits and, practically speaking, precludes every possibility of the introduction of illicit spirits into consumption through licensed channels in package form.

Control of Imports

The same rigid system of control which has been described in connection with spirits of domestic production has been applied also to imported spirits. Under the present regulations bulk spirits can be imported only on consignment to distillers, rectifiers or warehousemen eligible under the regulations to bottle domestic spirits for retail sale. Spirits imported in bottles are subject to the

same regulations with respect to the marking of bottles as those applicable to spirits of domestic origin. Strip stamps for imported spirits are kept under strict control by Customs and Internal Revenue officers jointly. Under certain conditions strip stamps are permitted to be sent abroad to be affixed to liquor bottles by the foreign distiller, but in such a case proper certificates from American consular officers are required to guard against any possibility of diversion. The methods employed greatly facilitate the business of legitimate importers and provide complete protection to the Government, both against the illicit or irregular entry of alcoholic beverages from abroad through licensed importers and against the fraudulent imitation of foreign brands by illicit producers in this country.

Retail Liquor Dealer Inspections

Following the repeal of the Prohibition Amendment, thousands of persons undertook to embark in the liquor business under the laws of the various states. While the vast majority of such persons were honest, law-abiding citizens, it is nevertheless a fact that included in these numbers were many who, during the period of Prohibition, were occupied in the illicit liquor traffic. Under these circumstances it is not surprising that during the early months following repeal there was everywhere a large sale of illicit spirits through regularly licensed stores, hotels, restaurants, clubs, taverns and tap rooms. This condition was particularly aggravated by reason of

the fact that neither the Federal government nor State or Municipal governments were at the outset able to give adequate supervision to retail vendors.

While recognizing the seriousness of this problem the Bureau of Internal Revenue, charged as it was with the duty of supervising the production of alcoholic beverages at the source for the purpose of tax collection, and likewise with the duty of concentrating upon illicit sources of supply, had no regularly appropriated funds which could be expended for the purpose of inspecting retail outlets. Under these circumstances the Department sought the cooperation of State and Municipal authorities, and, early in 1935, it set up so-called "joint projects" in a number of large cities, including New York, Chicago, Philadelphia, Pittsburgh, Buffalo, Milwaukee, San Francisco and Los Angeles. In each of these cities the Bureau of Internal Revenue appointed, without compensation other than their work-relief wage, a substantial number of persons taken from the local relief rolls as Deputy Collectors of Internal Revenue and assigned these Deputy Collectors to work jointly with an equal number of police officers detailed for the purpose by the city authorities in making a periodical routine inspection of all liquor package stores and all restaurants, hotels, clubs and tap rooms openly selling liquor at retail.

In all the "joint-project" cities, a large number of retailers were found who had not paid the Federal occupational tax,

and many who had failed to take out state or city licenses. Many infractions were found of the laws relating to the stamping of beer, as well as many cases of adulterating spirits in bottles open at the bar. So uniformly successful were these projects as a means of curing these evils and securing compliance not only with the Federal laws but with state and local laws, in weeding out law violators, and in eliminating the adulteration of spirits at the bar, that, beginning in September, 1935, the system was extended to cover all cities in the United States having a population in excess of 100,000. There are 96 such cities, and about 40% of the total number of approximately 400,000 retail dealers in liquor, wine and beer are located in these places. At the present time complete inspections of all retail dealers doing business in these communities are made with a frequency varying from one to three months and it is probably correct to say that the cities included in this program are now virtually free from the illicit liquor traffic except that which is carried on in the slum districts through private residences, speak-easies and dives.

It is extremely desirable that these routine inspections of retail liquor dealers should be extended to the smaller towns and even to rural communities, and the Bureau of Internal Revenue has contrived to assign a limited personnel to such inspection work in these latter places. It is not practicable, however, within the limits of funds now available, to carry on this work in the smaller

towns and rural communities with anything like the frequency that is possible in the project cities above referred to, and in many parts of the country no such inspections are being made at all. Estimates are now pending before the Bureau of the Budget which, if approved, will permit the periodic inspection of all places at which liquor is sold at retail with sufficient frequency to insure against fraudulent violations on the part of licensed dealers, not only in the large cities but in the smaller towns and villages. If this program can be carried through in its entirety it will close the only important gap which now remains through which bootleg spirits may be introduced into legitimate channels of trade.

CONTROL OF ILLICIT TRAFFIC

In dealing with the broad question of liquor-law enforcement, the policy of the Department has been, first, to place all elements of the legitimate industry under careful and, as far as practicable, complete supervision, with a view to insuring full compliance with the revenue laws on the part of all licensed distillers, brewers, rectifiers, and winemakers, and all distributors whether at wholesale or retail; and, second, to attack the illicit production, distribution, and sale of intoxicating beverages by concentrating on known or suspected sources of supply. In dealing with the second phase of this program, that is, the attempt eradication of illicit manufacture and sale, the Department has employed substantially the

same methods which were employed during the Prohibition period by the Bureau of Prohibition. Its agents have devoted a substantial part of their time and energy to the seizure and destruction of illicit stills, and the prosecution of those responsible for unlawful manufacturing operations. In some respects, however, the Department has gone far beyond the former Prohibition methods and, it is believed, has been far more successful in stamping out the illicit production of distilled spirits.

Raw Materials Investigations

To enable it better to concentrate upon illicit sources of supply the Department recommended and, in June, 1934, Congress enacted legislation authorizing the Commissioner of Internal Revenue to require all persons manufacturing or selling any materials of the character used in the manufacture of distilled spirits, such as corn sugar, cane and beet sugar, molasses, and yeast, to report daily all their sales to the field officers of the Bureau of Internal Revenue, giving the names and addresses of the persons to whom such sales were made. Under regulations issued pursuant to the authority contained in this legislation, the District Supervisors of the Alcohol Tax Unit are given a wealth of information by the producers and distributors of raw materials which is immediately made use of in the location of illicit manufacturing plants. With the aid of these regulations the Department is able to ascertain with great promptness and accuracy the location of such plants, and often the identity of the persons responsible for their operation.

During the eighteen-month period which has elapsed since the promulgation of these regulations, the illicit use of corn sugar and molasses, which are the chief ingredients used in the making of mash for distilled spirits, has been cut down to negligible proportions. Criminal operators using these commodities have very largely been driven out of business, or compelled to turn to cane and beet sugar or to the reclamation of denatured alcohol as the basis for their manufacturing operation. These latter products, while more readily procurable than corn sugar or molasses, are definitely inferior as materials to be used in the production of spirits, and result in the production of spirits of inferior quality which can be merchandised only with great difficulty and at unfavorable prices. The raw materials regulations have virtually put an end to large syndicated illicit manufacturing operations, have vastly increased the cost and difficulty of illicit manufacture, and have had an important influence on the whole problem of liquor-law enforcement.

Denatured Alcohol Regulations

As has been said, the Department's program for controlling the raw materials used in the manufacture of distilled spirits has had the effect of driving illicit operators to the use of other substances than corn sugar and molasses in the manufacture of their product. In recent months there has been an increasing tendency for illicit distillers to make use of denatured alcohol for this purpose. The Department has undertaken to meet this situation in two ways: first, by improving the quality of the

materials used in the denaturation of alcohol for industrial purposes so as to increase the difficulties which are involved in the unlawful removal of denaturants in an effort to render the spirits potable; and, second, by asking for legislation authorizing the Commissioner of Internal Revenue to require manufacturers and users of denatured alcohol and products manufactured from denatured alcohol to report their sales, shipments, and consignments of such alcohol or manufactured products, under the system that is applied to materials like molasses, sugar, and yeast. This legislation was enacted by Congress in August, 1935, and the Department has now issued regulations requiring daily returns from all the principal manufacturers and users of denatured alcohol, in order that it will be in a position to detect and prevent the diversion and redistillation of such alcohol for beverage use. While these regulations have not been in force long enough to determine certainly what their effect will be, there is no reason to suppose that they will not aid greatly in combatting the redistillation of industrial alcohol.

Seizures and Prosecutions

Notwithstanding the constantly diminishing illicit traffic in intoxicating beverages, the statistical results of the enforcement work of the Alcohol Tax Unit of the Bureau of Internal Revenue, measured in terms of the number of cases made, remain fairly constant. In considering

this point it is the Department's opinion that, due partly to improved enforcement methods, partly to improved cooperation with state and local authorities, partly to an improved enforcement personnel, and partly to a more sympathetic attitude on the part of prosecutors and judges, the Government is now apprehending and prosecuting a much higher proportion of liquor-law offenders than in the period of Prohibition. Following is a statement showing the number of stills seized and the number of prosecutions recommended and convictions obtained for violations of the internal revenue laws relating to distilled spirits from the time of the establishment of the Alcohol Tax Unit up to December 31, 1935:

Results of Enforcement Work of the Alcohol Tax Unit, by 6-Month Periods

July 1934 - December 1935

	July 1934 - December 1934	January 1935 - June 1935	July 1935 - December 1935
Stills Seized	7,086	8,626	8,054
Persons Arrested	14,177	17,448	16,548
Prosecutions Recommended*	15,231	18,454	16,772
Convictions Obtained*	5,729	9,379	9,142
Average Sentence	291 days	320 days	316 days
Average Fine	$340.	$359.	$330.

* Number of persons.

SMUGGLING

What has been said in regard to the methods of control of the illicit traffic in alcoholic beverages was chiefly in relation to domestic production. The smuggling problem has been given special attention along radically different lines.

Coordination of Treasury Enforcement Agencies

Since the smuggling of alcoholic beverages is a violation not only of the Customs laws but also the internal revenue laws, and since it is commonly linked with other illicit enterprises such as, for example, the smuggling of narcotics, the Treasury Department has attacked this phase of the enforcement problem through the coordinated efforts of all its police and investigative agencies, including not only the Customs Service and the Bureau of Internal Revenue, but also the Bureau of Narcotics, the Secret Service Division, and the Coast Guard. Since August, 1934, these agencies have cooperated in carrying out a carefully planned program calculated to put an end to the smuggling of alcoholic beverages, a traffic which, during the days of Prohibition, is said to have reached proportions amounting to as much as twenty million gallons of spirits annually.

There are two main elements in this program: first, cooperation with foreign governments in control measures and in the interchange of information relating to sources of supply and movements of contraband between ports; and, second, the maintenance of the patrol forces necessary to provide surveillance over smuggling craft at sea and to prevent

illicit landings, and the conduct of the investigations required to detect those financially responsible for contraband ventures.

Cooperation with Foreign Governments

With the assistance of the State Department the Treasury has been able to induce action by many governments looking to the suppression of the smuggling of beverage spirits into the United States. France has placed an embargo on spirits moving from St. Pierre et Miquelon, which was the smuggling base most commonly used during the Prohibition period. England has taken similar action with reference to St. Johns, Newfoundland, Belize, British Honduras, and other British possessions in the Western Hemisphere. Cuba, by executive decree, has prohibited the exportation of alcohol except for known legitimate purposes. Mexico is about to promulgate a similar decree. So effective has been the action taken by these and other governments, that virtually all bases of supply in the Western Hemisphere have been closed to alcohol smugglers. Since May 15, 1935, which was the effective date of the French decree closing St. Pierre et Miquelon, smugglers have been driven to the necessity of transporting alcohol by tramp steamers from European ports into waters adjacent to the United States or Canada and there transshipping the contraband to smuggling craft. This has proved to be a hazardous and expensive operation, and only five such ventures have been attempted, in each case involving the use of Danish and Norwegian tramp steamers taking cargo at Antwerp. The total of the contraband cargoes of the five steamers has amounted to approximately 375,000 gallons, of which probably not much more than one-half has been successfully landed on American

shores. This fairly represents the volume of the present smuggling traffic.

In this connection, it should be noted that there is no longer any smuggling of finished beverage spirits such as whiskey. The present very much reduced traffic in contraband spirits is limited to alcohol or neutral spirits which, when successfully smuggled into the United States, is chiefly used by illegal cutting plants in the production of a cheap grade of imitation whiskey for sale through speak-easies and similar resorts. It should be noted also that negotiations are now pending with the Government of Belgium which, if successfully consummated, will eliminate Belgian ports as a source of supply for this trade.

Cooperation of the State Department

The State Department has cooperated fully with the Treasury in its anti-smuggling program. Diplomatic and consular officers everywhere now keep in touch with vessel movements, with Customs and shipping officers in foreign countries, and with producing plants, and inform the Treasury promptly of all shipments of suspect cargoes. The Department has been of the greatest aid in negotiations looking to the cooperation of foreign governments in respect to control measures.

Enforcement Methods

The Coast Guard continues to perform the function of patrolling the coastal waters, both by vessel and by airplane, for the purpose of detecting and trailing smuggling craft. With its system of radio stations

this agency is able to keep currently advised of the movements of such craft and in this way to keep them under observation and to prevent, or at least to delay, the landing of their cargoes. The Coast Guard, the Alcohol Tax Unit, and the Customs Service maintain land patrols in coastal areas where smuggling operations are projected, and there is a constant liaison between these land patrols and Coast Guard vessels and planes. These patrol agencies are carefully synchronized with investigative work which is constantly going on in an effort to find out the plans of the smugglers to land their cargoes.

The Department has met with much success in this coordinated effort and in the year and a half during which this program has been carried on has seized many rum-running vessels and their cargoes and has successfully prosecuted many of the smuggling syndicates. It is believed that the backbone of the liquor smuggling operations has been broken by these methods. Although the traffic in smuggled alcohol still continues, the volume has been reduced to a mere trickle compared with what it was during the days of Prohibition, and it is not too much to expect that within the next few months organized alcohol smuggling will virtually cease to exist.

GENERAL RESULTS

Although the situation with respect to the manufacture or importation and sale of illicit alcoholic beverages is greatly improved and is steadily improving, it is, of course, impossible to gauge or estimate with any degree of accuracy the present volume of this kind of traffic. Such

leakage as there may have been through licensed outlets has been reduced to negligible proportions. Smuggling no longer accounts for any appreciable volume. Illicit distilleries have been hard-pressed to procure materials from which to manufacture their product. As the supply of legitimately produced spirits has improved in quality it has likewise materially lessened in price, thus cutting down the inducement for bootlegging, except, of course, in communities which prohibit the sale of intoxicants. Even in these communities it should be noted that the bulk of the sales, although prohibited under state or local law, consist of spirits taxpaid under the Federal laws. As has been seen, the Treasury Department has greatly improved its enforcement facilities, and there has likewise been a gradual increase in the effectiveness of the enforcement effort made by state and local authorities generally. All of these factors may be taken as pointing to the fact that the bootleg traffic is being reduced to narrow proportions.

Perhaps the best evidence of the present trend of the illicit traffic will be found in the results obtained both by state governments and by the Federal Government in the collection of liquor taxes. On this point it may be said generally that during the calendar year 1935 the amounts derived from all Federal alcoholic beverage taxes increased by one-fourth over the amounts collected in the preceding calendar year; and that the amounts collected from excise taxes on distilled spirits taken alone increased in the same period by more than 45 per cent. This, of course, means a proportionate increase in the consumption of taxpaid beverages, and, conversely, it means a decrease at least somewhat in proportion in the consumption of bootleg products.

The Federal Government is collecting today in taxes on alcoholic beverages a larger sum than ever before in the history of the country. It is, of course, to be borne in mind that the present tax rates are higher than the normal pre-war rates, and that there have been years in which consumption on a gallonage basis has been greater than at the present time. But, on the other hand, consumption of taxpaid alcoholic beverages has now approached a basis which, when allowance is made for the reduced purchasing power of a substantial part of our population, compares not unfavorably with the years prior to the adoption of the Prohibition Amendment. There is no important illicit traffic in either beer or wine, and it is safe to assume that, with the exception of wine and beer produced for home consumption under tax-exemption privileges, all wine and beer consumed in the United States today is fully taxpaid under the internal revenue laws. In an appraisal of the extent of the present illicit traffic in intoxicating beverages, therefore, in the light of the revenue returns, it will be sufficient to give the facts with reference to distilled spirits only.

During the five-year period from 1910 to 1914, inclusive, the average annual taxpaid consumption of distilled spirits for beverage use was 128,000,000 gallons. In the five-year period from 1915 to 1919, inclusive, the average annual taxpaid consumption was 110,000,000 gallons. During the calendar year 1935 taxpaid consumption was 92,000,000 gallons. Consumption was at an accelerated rate throughout the calendar year 1935, and it is now estimated that during the fiscal year ending July 30, 1936, taxpaid consumption will be approximately 105,000,000 gallons. The Treasury estimate of taxpaid consumption for the fiscal year 1937 is 121,000,000 gallons.

It appears, therefore, that the consumption of taxpaid beverage spirits is now not far below, and if present trends are maintained, will soon exceed, the annual rate of consumption in the five-year period immediately preceding the adoption of the Prohibition Amendment. It is, of course, true that there has been a substantial increase in population, per capita consumption today being ..74 gallons, as compared with an average of 1.11 gallons in the five-year period immediately before Prohibition. It must be remembered, however, that a large element of our population is unemployed and reduced to the bare necessities of life, and that this reduced per capita consumption of distilled spirits is undoubtedly in keeping with the diminished consumption of luxury commodities generally, and corresponds closely with the reduced per capita consumption of beer.

To sum up, all indexes point to the fact that the illicit traffic in intoxicating beverages is being gradually brought within satisfactory control; and there is every reason to expect that if the present efforts are continued and strengthened as far as practicable, the time will quickly arrive when it will cease to be a major enforcement problem.

March 11, 1936

H.N.G.

March 12, 1936

HM,Jr. talked to the President about the Canadian liquor thing. In view of the fact that MacKenzie-King has made a personal appeal, the President told the State Department that they can tell their story to Pat Harrison, but he is perfectly willing that we should stick by our guns and if Pat Harrison and the Committee in their wisdom decide that we are right they can simply say that they tried their best, but could not do anything.

TREASURY DEPARTMENT

Washington

FOR RELEASE, MORNING NEWSPAPERS,
Thursday, March 12, 1936.
3-11-36

Press Service
No. 7-1

Secretary of the Treasury Morgenthau today announced the final subscription and allotment figures with respect to the current offering of 2-3/4 percent Treasury Bonds of 1948-51 and 1-1/2 percent Treasury Notes of Series A-1941.

Subscriptions and allotments were divided among the several Federal Reserve districts and the Treasury as follows:

2-3/4 PERCENT TREASURY BONDS OF 1948-51

Federal Reserve District	Total Cash Subscriptions Received	Total Exchange Subscriptions Received (Allotted in full)	Total Subscriptions Received	Total Subscriptions Allotted
Boston	$ 455,436,100	$ 6,650,100	$ 462,086,200	$ 71,480,350
New York	2,730,256,800	379,581,000	3,109,837,800	741,497,450
Philadelphia	257,631,900	6,750,100	264,382,000	43,217,050
Cleveland	235,022,750	5,587,300	240,610,050	42,228,450
Richmond	123,417,050	5,325,800	128,742,850	26,660,900
Atlanta	221,608,550	2,874,700	224,483,250	35,661,300
Chicago	429,927,450	51,286,000	481,213,450	117,081,150
St. Louis	112,796,750	4,482,700	117,279,450	24,811,750
Minneapolis	53,345,500	8,262,500	61,608,000	17,578,700
Kansas City	79,313,050	3,980,400	83,293,450	19,468,500
Dallas	85,536,000	831,700	86,367,700	18,446,700
San Francisco	320,596,950	11,928,500	332,525,450	56,154,450
Treasury	2,025,090	8,934,100	10,959,100	9,216,100
TOTAL	$5,106,513,850	$496,474,900	$5,603,398,750	$1,223,502,850

1-1/2 PERCENT TREASURY NOTES OF SERIES A-1941

Federal Reserve District	Total Cash Subscriptions Received	Total Exchange Subscriptions Received (Allotted in full)	Total Subscriptions Received	Total Subscriptions Allotted
Boston	$ 258,078,400	$ 1,541,000	$ 259,619,400	$ 50,656,500
New York	1,652,370,300	36,436,800	1,688,807,100	335,820,000
Philadelphia	175,841,700	1,609,200	177,450,900	34,008,800
Cleveland	219,259,600	3,475,000	222,734,600	44,495,300
Richmond	106,698,600	151,500	106,850,100	20,897,600
Atlanta	103,736,600	121,300	103,857,900	20,799,900
Chicago	319,126,600	2,436,100	321,562,700	63,872,900
St. Louis	90,314,300	377,900	90,692,200	19,129,300
Minneapolis	40,585,600	161,000	40,746,600	8,529,400
Kansas City	63,556,800	155,700	63,712,500	13,778,400
Dallas	64,123,300	18,000	64,141,300	15,325,000
San Francisco	260,372,500	1,510,000	261,782,500	49,216,000
Treasury	500,000	85,000	585,000	175,000
TOTAL	$3,354,464,300	$48,078,500	$3,402,542,800	$676,704,100

March 12, 1936

Among those called in for suggestions and advice in connection with the Secretary's conferences on new sources of revenuefrom taxes was Roswell Magill.

After Magill's return to New York, Earle Bailie telephoned the Secretary and told him he had asked Mr. Magill to advise J. & W. Seligman & Company regarding the proposed new corporation tax, but Magill had said that, on advice of Mr. Oliphant, he could not do any work of that nature for the firm inasmuch as he had been down here in Washington in an advisory capacity.

Mr. Morgenthau told Bailie that as far as he was concerned, he did not care whether Magill worked with Seligman & Co. or not. He did, however, tell Mrs. Klotz to get in touch with Oliphant and tell him to call Magill and straighten the matter out with him. Oliphant's reaction was that this was unnecessary since he had already taken the stand that Magill should not represent Seligman and he, Oliphant, could not change his opinion. Oliphant said Magill had asked him as a friend to advise him and he had definitely told Magill that it would be a great mistake, in his estimation, for Magill after having been here at the Treasury in an advisory capacity to go back to New York and represent Seligman's on a matter opposing the tax legislation which the Treasury was advocating and hoping to have enacted into law; that if he did want to work with Seligman he should wait until the legislation had been adopted. However, Mr. Oliphant did call Mr. Magill and reported there was perfect understanding between the two of them.

Mr. Bailie telephoned directly to Mr. Oliphant. By this time, HM,Jr. was annoyed over the confusion and telephoned Mr. Bailie. He told him that he was ill; that he did not want to argue; that since he had told Mr. Bailie that he did not care whether Magill represented Seligman & Co. or not that he had changed his mind. At this point Mr. Bailie interrupted to say that HM,Jr. had not said that Magill could represent Seligman; that what he had said was that he would take it under advisement. That cleared the whole matter up as far as HM,Jr. was concerned, and Mr. Bailie remarked that while he thought HM,Jr. was absolutely wrong, he would be guided by his wishes and forget the whole matter. However, he did say, "Henry, no one would know anything about it," and that definitely closed the matter as far as HM,Jr. was

concerned because any dealings that he would have with Seligman and Magill and Oliphant would be such that everyone would know about them.

The next development we learned of was that Mr. Bailie had turned the thing over to Mr. Jaretzki. The Secretary instructed Mr. Oliphant not to see Mr. Jaretzki.

Today Mr. Jaretzki came to Washington, tried to see Mr. Oliphant who would not see him. He then talked to Mrs. Klotz on the telephone. He told her he had been in to see Mr. Turney and Mr. Brown of the General Counsel's staff, but that it was a waste of time seeing those men. He got nowhere.

In connection with the above, there is quoted below a letter from Mr. Magill to the Secretary, dated today, March 12.

"35 Claremont Avenue

12th March 1936

Dear Mr. Morgenthau:

Since you have already been disturbed more than I wish you might by discussions by our friends of the matter of my advising Earle Bailie regarding the proposed new corporation tax, I have not wanted to bother you too. But I do want you to know, first, that in our first conference I told Alfred Jaretzki (and he agreed) that of course I would not act at all in the matter without discussing it first with you; and second, that as soon as I learned your point of view, we ended the whole thing at once.

Sometime I want to give you the complete story; but for the present, I simply want to wish you a very speedy recovery and as pleasant a vacation as you can find. With all good wishes,

Sincerely yours,

(Signed) Roswell Magill."

Thursday
March 12, 1936

W. C. Taylor: Hello, Cochran, this is Taylor talking. The Secretary is sick today and wanted me to talk to you.

H. Merle Cochran: I see. Oh, Mr. Taylor, have you seen that message in regard to my coming back?

T: Yes

C: Mr. Taylor, I wanted to explain to the Secretary - I know I can talk to you just as confidentially -

T: That's right.

C: I came back last Fall from my visit with the Secretary. I've had quite a bit of difficulty here in getting away on these trips for you people - Do you hear me?

T: Yes

C: There has been a lot of objection on the part of --- entirely petty and personal --- and even when I went to Rome I didn't get the trip approved until twodays before I went down. And when this trip came up in regard to my going home on this occasion to solve the objections that were raised -

T: Yes, I saw those

C: I mean, the staff here can carry on entirely satisfactorily and there really was no excuse for them failing to agree about this Cablegram. But since you people have excused them from that then there is no reason why I shouldn't get away.

T: Well, there's no reason that's been raised why you shouldn't. The reason for sending that cable the other day was simply in case something developed over there that might make it advisable for - from our standpoint to have you stay.

C: I - I wasn't sure, I - whether that was the side or not but I know that the Ambassador has written back personally to Mr. Hull protesting against my going on these trips for you.

T: Well - I'm very sorry to hear that, but the occasion of that particular cable was entirely the feeling on our

part that it just might be well to have you check again before you left so that we might change our mind.

C: Yes - but I mean, there - there may be objection still but to be quite honest I'm very anxious to come home now just on account of this and get it straightened out with you people and with our Department. I mean it's something I can't write about and I've hesitated mention until now.

T: Well, I think you'd - can rest assured that anything of that sort will be straightened out and that unless you hear - I want you to check again with us according to instructions that were to make your plans to come unless we tell you not to.

C: All right, because I already have appointments over in London, you see, with Governor Norman and some of those people.

T: - Just a minute -

C: I say I already have appointments in London with Governor Norman.

T: That's right.

C: And some of the officials there.

T: Well, I wouldn't - the only possibility of not going through with that schedule is that we would ask you to stay there on account of something that might be developing at that time on the other side.

C: Yes

T: And if you'll just go through with checking - be sure to check with us before you leave Paris on that trip - why that's the only thing that's necessary to do.

C: Yes, then I shall wire you just one week before getting your approval as to whether I am to come?

T: That's right.

C: My position over here is going to be almost untenable unless I can get back one of these days before very long and get this thing adjusted.

1176

T: Well, unless something unforeseen happens why you plan on coming back.

C: All right, fine.

T: All right, Goodbye.

C: Goodbye, thank you so much.

T: Right.

TREASURY DEPARTMENT

WASHINGTON

March 20, 1936

FURTHER CONFERENCE AT THE WHITE HOUSE ON FRIDAY, MARCH 13, 1936 REGARDING THE RELIEF NEEDS FOR THE FISCAL YEAR 1937

-oOo-

Those present besides the President were Messrs. Hopkins, Gill and Bell. (The Secretary was ill and could not attend.)

The President made a statement something like this with respect to Harry Hopkins' needs: At the first conference he indicated he would need, to run through the balance of this fiscal year, the sum of $250,000,000

In the last few days we have allocated to him 25,000,000

leaving a balance for further allocation of 225,000,000

We have on hand a free balance of 83,000,000

leaving yet to be found from other sources the sum of $142,000,000

The President estimated that, through the recent letters sent to all organizations, we can probably get $70,000,000. The balance we will have to take out of next year's funds by making the new appropriation immediately available. That will mean $72,000,000.

The President then read over Mr. Hopkins' draft of the proposed message. The figures contained in this message suggested

$2,500,000,000 as a minimum, which was not in line with the agreement reached at the previous conference to have a maximum of $2,000,000,000. Mr. Hopkins explained that his estimate was based on the needs of the situation and not on the fiscal requirements, as set out in the Budget Message. The President said that was all right but he could not accept it and he would not be able to ask for more than $2,000,000,000.

The President then read the draft of another message which was prepared by Donald Richberg. This message went into the matter that the President had discussed at the previous conference, that is, of having industry put on additional people in order to lighten the load of the Federal Government. It also brought in N.R.A.

After some discussion of these two messages the President started dictating the first draft of the proposed relief message. He included practically all of the matters that he discussed at the previous conference.

DWB

TREASURY DEPARTMENT

WASHINGTON

March 13, 1936

Memorandum to the Secretary:

As I advised you over the telephone this morning, I gave Dr. Burgess an order yesterday to purchase for account of the Postal Savings System, $10,000,000 face amount of either 2 7/8% ~~(new)~~ or 2¾% (new) Treasury bonds. I talked with him a few moments ago and he advised me that he had purchased $8,700,000 of these securities and probably would pick up the other $1,300,000 before the close of business today. I advised him of your views regarding the limit of approximately $5,000,000 a day. He said that he would be glad to make the investments in that manner but if you were anxious to get a substantial part of the funds invested, this would be a good time to do it in view of the fact that the dealers have a great many of these particular securities on hand. Then too, purchases could be made without, in any way, disturbing the market.

I suggest that Dr. Burgess be given a further order for $10,000,000 in the same two issues permitting him to use his own judgment as to how fast it shall be invested.

O.K.
HM Jr

D. W. B.

March 13, 1938

HM,Jr. called the President from home, this morning. The following conversation took place:

HM,Jr: "I am going to see the doctor. They tell me I can go to a matinee. I shall see Alfred Lunt and Lynn Fontanne in Idiot's Delight. I hear that you are a 'naughty boy' because you have done nothing on your relief message." The President replied, "Oh, yes, I have! I now have Donald Richberg with me and am talking to him about it. I have two drafts on the message. I am having a meeting tonight."

Mr. Morgenthau then said to the President, "There are two or three bills on Housing, each one opposed to the other. They are terrible and they haven't gotten anywhere yet. I am disappointed that they haven't gotten together, for your sake."

COPY

March 14, 1936.

From: Spagent, Shanghai, China.
To: The Secretary of the Treasury.

Message from Professor Buck: Chen sailed last night PRESIDENT PIERCE. Attitude of Kung one of hearty co-operation with United States Treasury. Apparently policy one of continuing managed currency, using silver and some gold metal reserve and currency redeemable in foreign exchange, but not linked to any country's currency. Possibly some use of silver in token coins. Determined not to return to silver standard. Desires price of silver not to fall below parity and favors a higher price now that China is off silver. Still anxious to sell some silver to increase foreign exchange balance or else some other guarantee of assistance in an emergency requiring additional foreign exchange.

COPY

PARAPHRASE OF CABLE RECEIVED FROM PROFESSOR BUCK

Shanghai, China,
March 14, 1936.

Chen left last night, March 13, on SS President Pierce.

Kung's attitude is one of hearty cooperation with the United States Treasury. Apparent policy is that of continuation of managed currency with the use of silver and partly gold metal reserve and currency redeemable in foreign exchange, although not to be linked to the currency of any other country. Some silver in token coins may possibly be used. Resolved not to return to silver standard. Now that China has left silver standard favors a higher price for the metal and also desires price not to fall below parity. Still desires to sell some silver in order to increase balance of foreign exchange or to have some other guarantee of assistance should an emergency arise requiring additional foreign exchange.

Note: The parity price for silver, figured on China's new currency, would be 40¢ per ounce.

approx March 15
124, 936

TO THE SECRETARY OF THE TREASURY

Here is my program. The extent of the program is a matter of policy which the President and you will determine.

My judgment is that Senator Wagner and the opinion he represents will want a program of at least this size. My judgment further is that it is extremely unlikely they will be able to accomplish the program of the first two years. Still, the Federal investment for the whole program is modest. Note the emphasis throughout on decentralization.

P.O

PROGRAM FOR SLUM CLEARANCE.

1. Any slum clearance or rehabilitation projects subsidized by the Federal Government shall be to replace old housing condemned under fire and sanitary codes and actually demolished.
   a) The number of family units built shall not exceed the number destroyed.
   b) The new housing may be on the site of the old housing or it may be elsewhere.

2. Any ~~new~~ housing subsidized by the Federal Government shall conform to minimum standards of adequacy and to maximum rent schedules prescribed by the Secretary of the Interior.
   a) Housing shall be as low in cost as possible and built to last 30 years. Design, construction, and equipment shall be simple and inexpensive.
   b) Average rents of subsidized housing may not exceed average paid by families in slum areas where clearance is made.

3. Tenancy must be strictly limited to families unable to pay an economic rent for unsubsidized housing, new or old, of adequate standards.

4. All housing projects must be initiated, the sites selected and acquired, the buildings constructed and managed, by non-Federal agencies.

a) The Secretary of the Interior or The Coordinating Board for Housing, if such a body is established, shall have power to collaborate with State, local, or private agencies in the preparation of plans and the organization of projects.

5. Fifty per cent of the rentals required to support the housing projects shall be obtained from the rentals actually charged the tenants; twenty-five per cent shall be paid as a subsidy by the Federal Government; and twenty-five per cent shall be paid as a subsidy by State governments, local governments, or private citizens, acting jointly or severally.

a) The Federal subsidy shall be payable in annual installments over the term of the mortgage.

b) State, local, and private subsidies shall be paid in such form as suits the giver. Tax exemption shall be an acceptable form.

6. The following forms of financing are suggested:

a) Borrowings by State or local governments secured by their full faith and credit, the bonds to be sold to banks, insurance companies, private investors, etc.

b) Borrowings by State or local agencies or private corporations secured by mortgages on one or more housing projects, the mortgages to be insured by

the FHA and to be sold to banks, insurance companies, National Mortgage Associations, private investors, etc., or the RFC Mortgage Company.

c) Eighty per cent first mortgages as in (b) plus twenty per cent second mortgages to be sold to the RFC Mortgage Company.

7. All subsidized housing which involves the Federal Housing Administration or the RFC Mortgage Company shall be submitted for approval to the Coordinating Board of Housing, and such approval shall determine the action of the Federal Housing Administration and the RFC Mortgage Company.

8. The Federal Government will agree to subsidize 20,000 dwellings units in 1936-37 and to increase this number at the approximate geometric rate of 50 per cent per year for the succeeding four years.

a) The following schedule shows the full five-year program:

Fiscal year	Number of units Subsidized each year	Cumulative
1936-37	20,000	20,000
1937-38	30,000	50,000
1938-39	45,000	95,000
1939-40	67,000	162,000
1940-41	100,000	262,000

9. The Federal Government will agree to finance by second mortgage or otherwise 20 per cent of all units constructed each year.

a) The following schedule shows the number of units to be Federally financed.

Fiscal year	Number of units financed each year
1936-37	4,000
1937-38	6,000
1938-39	9,000
1939-40	13,400
1940-41	20,000

10. The following estimate of costs is presented. The Federal subsidy is assumed to be $2 per room per month for 30 years, or one-quarter of an $8 economic rent. A dwelling unit is assumed to cost $3,000.

Fiscal year	Yearly Appropriation for Annual Subsidy	Recoverable Mortgage Loans
1936-37	1,680,000	12,000,000
1937-38	4,200,000	18,000,000
1938-39	7,980,000	27,000,000
1939-40	13,608,000	40,000,000
1940-41	21,008,000	60,000,000

N.B. The $21,000,000 subsidy would continue annually for 25 years, after which period it would diminish for 5 years to $3,400,000 in 1969-70 and to nothing in 1970-71. The present value of the total subsidy is

$390,900,000, figured at 3 per cent compounded semi-annually. The capital value of the houses built over the five-year period is $786,000,000.

Peter G. Gross

COPY

March 16, 1936.

From: Spagent, Shanghai, China.

To: The Secretary of the Treasury.

Message from Professor Buck: Your message suggesting discussions be confined to monetary problems was helpful to Kung to resist pressure for consideration of other matters.

TREASURY DEPARTMENT

WASHINGTON

March 20, 1936

CONFERENCE ON MONDAY, MARCH 16, 1936, AT THE WHITE HOUSE WITH CONGRESSIONAL LEADERS CONCERNING THE RELIEF MESSAGE

-oOo-

Those present besides the President were the Vice President, the Speaker of the House, Senators Glass, Robinson and Byrnes, Congressmen Buchanan and Bankhead, and Mr. Hopkins, Mr. Gill and Mr. Bell.

The President started the conference by going over the entire relief situation as it is today, covering a great deal of the ground that we have discussed in the previous conferences and also many of the figures contained in the relief message. He talked on this subject for at least thirty minutes and made a very clear and convincing statement on the matter. He also went into the political situation somewhat, stating that it was politically important that, first, he should not exceed the maximum amount referred to in the Budget for relief, and, second, that he should state that this would be the third year of a declining deficit.

He also called the leaders' attention to the situation which would develop if any attempt were made to earmark the funds appro-

priated in the relief bill. He told them that he intended every cent of this money to go to Mr. Hopkins to be administered by him alone, and that it would be for relief work projects such as he has carried on during the past year. The President said he realized that this was a campaign year and that there would be a clamor for more money for particular kinds of work and in specific areas. He said that we had provided in the Budget for a permanent C.C.C. organization of 300,000 men at a cost of about $300,000,000; that there was also included in the Budget an item covering general public works at a cost of about $400,000,000, out of which, including last year's appropriation, there would be expended approximately $600,000,000. There would also be expended out of prior year appropriations for emergency purposes approximately $1,000,000,000, making a total of $1,600,000,000 for C.C.C. and public works of one kind or another.

The President said he did not feel that we are justified in going beyond this amount. He frankly told the leaders that if the amount is earmarked in any way it will be necessary to increase it to take care of the relief problem.

Speaker Byrnes and Congressman Buchanan thought that there would be some attempt to increase the amount, maybe for C.C.C., but on the other hand there might be an attempt to reduce the appropriation to $1,000,000,000 for strictly relief purposes. They also thought that there might be some further attempt to direct the

President to go back to the direct relief methods, but they thought that they had a majority sufficient to put through the kind of a bill the President desires.

Senator Byrnes said that he thought his main trouble would be to avoid decreasing the amount of the appropriation to $1,000,000,000. Of course, there would be certain factions which would want to increase the amount and earmark it for certain specific public works, but Senator Robinson and the Vice President thought they could put through the relief bill proposed.

The President then read the message. The leaders generally agreed that it was along the right lines. They all agreed to support the President in his request and to do everything possible to put through the bill in the form in which he wanted it.

DWB

74TH CONGRESS } HOUSE OF REPRESENTATIVES { DOCUMENT
2d Session } { No. 427

RECOMMENDATION FOR AN APPROPRIATION FOR RELIEF OF UNEMPLOYMENT

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

A RECOMMENDATION FOR AN APPROPRIATION FOR THE RELIEF OF UNEMPLOYMENT

MARCH 18, 1936.—Referred to the Committee on Appropriations and ordered to be printed

To the Congress of the United States:

In my Budget message of January 3, 1936, I reserved making a recommendation for an appropriation for the relief of unemployment, stating that an estimate and recommendation could be better made at a later date. I am now prepared to submit such a recommendation, and this message should be regarded as supplemental to the Budget message.

In asking the Congress for an appropriation to meet the needs of the destitute unemployed during the coming fiscal year, certain facts should be clearly set forth.

(1) Since the spring of 1933, there has been a gain in reemployment in each successive year. At least 5,000,000 more people were at work in December 1935 than in March 1933.

(2) In spite of these great gains, there are at present approximately 5,300,000 families and unattached persons who are in need of some form of public assistance—3,800,000 families and unattached persons on the works program and 1,500,000 on local and State relief rolls. Every thinking person knows that this problem of unemployment is the most difficult one before the country.

(3) These figures, large as they are, do not, of course include all those who seek work in the United States. In none of these figures is included the many unemployed who are not on relief but who are experiencing great difficulties in maintaining independent support. Neither are there included many others not on the relief rolls who

are content with occasional employment; nor some who are so constituted that they do not desire to work; nor many young people who cannot get work and are obliged to share the livelihood earned by their parents. Because of the impossibility of an exact definition of what constitutes unemployment, no figures which purport to estimate the total unemployed in the Nation can be even approximately accurate.

(4) Nearly all the 1,500,000 unemployable families or unemployable unattached persons are being cared for almost wholly from State or local funds. A very small number of these families or individuals have begun to receive a comparatively small amount of Federal aid under the provisions of the Social Security Act.

The foregoing figures indicate the problem before us. It is a problem to be faced not merely by the Congress and the Executive, not merely by the representatives of Government in the States and localities, but by all of the American people. It is not exclusively the problem of the poor and the unfortunate themselves. It is more particularly the problem of those who have been more fortunate under our system of government and our economy.

It will not do to say that these needy unemployed must or should shift for themselves. It will not be good for any of us to take that attitude. Neither will it do to say that it is a problem for the States and the localities. If we concede that it is primarily the duty of each locality to care for its destitute unemployed, and that if its resources are inadequate, it must then turn to the State for help, we must still face the fact that the credit and the resources of local governments and States have been freely drawn upon in the last few years and they have not been sufficient.

It has been said by persons ignorant or careless of the truth that Federal relief measures have encouraged States, counties, and municipalities to shirk their duty and shift their financial responsibilities to the Federal Government. The fact is that during 1935 State and local governments spent $466,000,000 for emergency relief, which was 13 percent more than these governmental bodies spent in 1934; 49 percent more than they spent in 1933; and 58 percent more than they spent in 1932. Let it also be noted that the great majority of State and local governments are today taking care not only of the 1,500,000 unemployables, but are also contributing large amounts to the Federal works program.

To expect that States and municipalities should at the present time bear a vastly increased proportion of the cost of relief is to ignore the fact that there are State constitutional limitations, and the fact that most of our counties and municipalities are only now emerging from tax delinquency difficulties. Let us further remember that by far the largest part of local taxes is levied on real estate. To increase this form of tax burden on the small property owners of the Nation would be unjustified. It is true that some States, fortunately few, have taken an undue advantage of Federal appropriations, but most States have cooperated wholeheartedly in raising relief funds, even to the extent of amending State constitutions. It is not desired in the next fiscal year to encourage any States to continue to shirk. The Federal Government cannot maintain relief for unemployables in any State.

The Federal Government, then, faces the responsibility of continuing to provide work for the needy unemployed who cannot be taken care of by State and local funds.

During the current fiscal year, the cost of relief actually paid out of the Treasury will amount to approximately $3,500,000,000.

During the next fiscal year, 1937, more than $1,000,000,000 will be spent out of the Treasury from prior-year appropriations. Practically all of these expenditures will be from allocations made to large projects which could not possibly be completed within this fiscal year. In addition to this amount, the Budget contains estimated expenditures aggregating $600,000,000 from appropriations recommended for the Civilian Conservation Corps and various public works.

If to this total of $1,600,000,000 there were added $2,000,000,000 to be expended for relief in the fiscal year 1937, the total for this purpose would just about equal the amount that is being now expended in the fiscal year 1936. An appropriation in this amount would be within the limit set by the Budget message, and would in effect provide for the third successive year a reduction in the deficit.

This statement as to the Budget program of course depends upon the action of the Congress with respect to the substitute taxes, the reimbursement taxes and the new taxes which I have recommended to replace the lost revenues and to supply the new revenue made necessary by the decision of the Supreme Court invalidating the Agricultural Adjustment Act and by the action of the Congress in appropriating for the immediate payment at the 1945 value of the veterans' adjusted-service certificates. This latter action, as you will recall, requires additional revenue in the amount of $120,000,000 annually for 9 years. The agricultural program requires annual substitute taxes of $500,000,000 and there must be raised within the next 3 years $517,000,000 of revenue to reimburse the Treasury for processing taxes lost in this fiscal year by reason of the Supreme Court's decision.

I am, however, not asking this Congress to appropriate $2,000,000,000.

I am asking only for an appropriation of $1,500,000,000 to the Works Progress Administration. It will be their responsibility to provide work for the destitute unemployed. This request together with those previously submitted to the Congress to provide for the Civilian Conservation Corps and certain public works will, if acted upon favorably by the Congress, give security during the next fiscal year to those most in need, on condition, however, that private employers hire many of those now on relief rolls.

The trend of reemployment is upward. But this trend, at its present rate of progress, is inadequate. I propose, therefore, that we ask private business to extend its operations so as to absorb an increasing number of the unemployed.

Frankly, there is little evidence that large and small employers by individual and uncoordinated action can absorb large numbers of new employees. A vigorous effort on a national scale is necessary by voluntary, concerted action of private industry.

Under the National Recovery Administration, the Nation learned the value of shorter hours in their application to a whole industry. In almost every case, the shorter hours were approved by the great majority of individual operators within the industry. To the Federal Government was given the task of policing against the minority who came to be known as "chiselers". It was clear that "chiseling" by a few would undermine and eventually destroy the large, honest majority. But the public authority to require the shorter hours

TREASURY DEPARTMENT

WASHINGTON March 18.)

MEMORANDUM FOR THE SECRETARY:

SUBJECT: Present status of legislation affecting imports of Canadian whiskey.

The provision for an "embargo" on imports of Canadian whiskey was reported favorably to the Senate Finance Committee by the Subcommittee of which Senator King is Chairman, about March 12.

Under Secretary of State Phillips advised Senators Harrison, George and King in a conference in the office of the Secretary of the Senate, at which Mr. Hester was present, that the State Department objected to this provision. During this conference Mr. Phillips was requested by Mr. Hester to advise the Senators of what occurred immediately preceding the signing of the Trade Agreement, Mr. Hester meaning the reservation made at the request of the Treasury Department that the Trade Agreement was intended and understood to have no effect upon the policy of the Treasury in seeking this embargo legislation. Mr. Phillips declined to advise the Senators to this effect. Thereafter, Senator Harrison informed the full Committee that he had been informed by Mr. Phillips that the State Department objected to the provision on the ground that it violated the Trade Agreement. Senator Clark then demanded that Mr. Phillips appear before the full

Committee and subject himself to the same cross-examination that the Treasury representative had undergone. Mr. Phillips was accordingly invited to appear and express the views of the State Department.

Senator Harrison subsequently decided, however, that it would be preferable for the two Departments to reconcile their conflicting views with respect to the legislation and to agree, if possible, upon some modification which would render the provision less objectionable to the Canadian Government. The hearing was therefore postponed until Tuesday, March 17, Senator Harrison expressing the hope that the two Departments would be able in the meantime to agree upon a draft and thus eliminate the necessity for the airing of their divergent views before the full Committee.

In the period between March 13 and 17, pursuant to Senator Harrison's suggestion, a series of conferences were held between representatives of the two Departments (Messrs. Phillips, Moore, Hackworth and Hickerson for the State Department; Messrs. Taylor, Hester, Frank, Klaus and Graves for the Treasury Department). The two Departments, however, were obliged to report at the meeting of the Committee on March 17 that no agreement had been reached. The Treasury Department had, however, offered a number of concessions to the State Department and Mr. Phillips advised Senator Harrison at the hearing that it was his opinion that if a few days additional time were allowed the two Departments would be able to agree upon a draft. The Committee accordingly postponed further consideration of the matter until March 20.

Following the adjournment of the Committee on March 17, the Treasury representatives met immediately with the representatives of the State Department in an effort further to revise the language of the provision so that it would meet the objections of the State Department; and at the end of the day had worked out a draft which the State Department representatives indicated would be satisfactory to them. The State Department representatives indicated, however, that it would be necessary for them to submit this draft to the Canadian Minister for his consideration, which they agreed to do at once; and they told the Treasury representatives that on the following day they would be advised whether the modified draft was acceptable.

During the course of the discussions between the two Departments on March 17, Under Secretary Phillips was advised by telephone by the American Minister at Ottawa that the proposed legislation had been made the subject of debate that day on the floor of the Canadian Parliament, in the course of which the Prime Minister was alleged to have said that the proposed action by the American Government would, in his opinion, afford grounds to Canada for the rescission of the Trade Agreement.

This message from Ottawa appeared to give grave concern to Mr. Phillips and the other State Department officials who were at the time in conference with the Treasury representatives. It was, of course, pointed out by the Treasury representatives that in view of the reservations expressly made by the American Government at the time of

signing the Trade Agreement the proposed legislation obviously could have no bearing on the Agreement. The State Department representatives acceded to this view; but in the end they appeared to entertain the opinion that regardless of this fact the proposed legislation, in any form, would be so objectionable to Canada as to lead to the possibility of the abrogation of the Trade Agreement and that, therefore, the State Department would be forced to do everything in its power to prevent its enactment.

Upon the adjournment of the conference between the representatives of the two Departments on March 17, the understanding was, as has been said, that the State Department would advise the Treasury Department after conferring with the Canadian Minister whether the proposition made by the Treasury Department in the course of the conference would be acceptable to the State Department. No express word has since been communicated to the Treasury Department on this proposition. Under Secretary Phillips, however, has advised Mr. Taylor, in substance, that in view of the attitude of the Canadian Government the State Department can not agree to any legislation whatsoever on this subject but will insist that the whole matter be dropped.

Following the conference on March 17, Mr. Phillips has been in touch with certain members of the Senate Finance Committee and has arranged for a further postponement of the hearings until March 24, at which time it is understood that Secretary Hull will appear personally

before the Committee with a view to persuading the Committee to drop the legislation.

The Treasury Department, at Senator Harrison's request, has gone to great lengths to modify the proposed legislation in such a way as to make it acceptable to the State Department; and in the end it submitted to the State Department a revised draft of the legislation which impressed the subordinate officers of the State Department as meeting virtually every objection which had been raised against the original draft. In the end, however, the State Department took the view, as above noted, that it could not accept any legislation on this subject in any form whatsoever.

At the hearing which will occur on March 24, the intention is to have Mr. Hester appear before the Senate Finance Committee and make out the strongest possible case for the retention of the provision. Secretary Hull will, of course, urge its abandonment. The outcome appears extremely doubtful. Mr. Hester has, of course, been before the Committee in connection with other provisions of the Omnibus Liquor Bill as well as the provision affecting the Canadian distillers, and will have a number of friends among the Committee members. Senators Bailey, Clark, Guffey, Capper, and Costigan can certainly be counted upon and probably Senator Barkley also. Some of these Senators were members of the Subcommittee which reported the Canadian provision to the full Committee, and most of them were originally hostile to the provision but became

convinced of its advisability after they learned the facts from Mr. Hester's testimony. As to the remaining members nothing can be said with certainty, although it is probable that a number will go along with Senators Clark and Bailey and other friendly Senators. We know definitely that Senators Harrison, George and King will follow the State Department and will no doubt, take a considerable number of other Senators with them.

One thing which is of concern is the indicated likelihood that Secretary Hull will say or allow Senator Harrison to say that the President is opposed to the enactment of this legislation in any form in view of the attitude of the Canadian Government. It is understood that Senator Harrison has already made this statement to a number of the members of the Committee.

It is understood that Secretary Hull in any event will say to the Committee that if this legislation should be enacted in any form it will mean the abrogation of the Canadian Trade Agreement. While there is no doubt that the enactment of the legislation might conceivably result in the abrogation of the Agreement on the part of Canada, we feel here that the Canadians have taken their position in opposition to this legislation largely as a threat and that there is no substantial danger that the Trade Agreement would in fact be terminated as the result of the proposed action. The following facts are to be remembered; first, that this point was specially reserved by the American Government at the request of the Treasury Department when the

Trade Agreement was consummated; and, second, that the very people (that is, the Canadian distillers) who have stirred up the opposition to the pending legislation would themselves be the chief losers if the Agreement should now be abrogated, since this would mean the restoration of the old $5.00 duty on their whiskey.

We secured from Canada a transcript of the proceedings in the Canadian Parliament, which are referred to above. It is attached hereto. You will find that the discussion was by no means as hostile to the legislation as the State Department originally indicated. Minister Euler and Prime Minister King referred to the proposed legislation as being of purely domestic concern to the United States and pointed out that the matter was not ~~now~~ new but had long been under discussion here. They, of course, indicate the possibility of reprisal but make no direct claim that the proposed legislation would be in violation of the Trade Agreement.

In the absence of further instructions the Department will continue to do its utmost to secure the adoption of the proposed provision. In this connection, it is understood that Senators Clark, Bailey and Bone ~~Gore~~ intend to carry the question to the floor of the Senate in the event the Finance Committee should accede to the request of the State Department and omit the disputed provision from the pending bill.

This memorandum is submitted for your information at the request of Mr. McReynolds.

GRAVES

CANADA PROTESTS OUR LIQUOR RULINGS

Ottawa Says Bond Label Ban and Fines for Imports in Prohibition Days Violate Treaty.

THREATENS TO END PACT

Holds Trade Agreement Barred Restrictions—Treasury Delays Label Order 6 Months.

Special to THE NEW YORK TIMES.

WASHINGTON, March 20.- Representations have been made to the State Department by Canada against some Treasury policies which affect adversely the export of Canadian liquor to the United States, but the Treasury has not indicated that it will modify its policies.

The State Department is concerned because the representations have been accompanied by government expressions in the House of Commons in Ottawa, hinting that if a satisfactory adjustment is not reached, Canada may cancel the reciprocal trade agreement recently concluded which is now in process of ratification by Canada. Cancellation is possible under the treaty terms on six months' notice.

The Ottawa Government contends that the Treasury practices are contrary to provisions of the trade agreement. Involved are two Treasury rulings and a bill pending in Congress which has been offered by Representative Doughton, chairman of the House Ways and Means Committee with the support of the Treasury.

The rulings are:

1. Liquor in bottles, even when imported from Canada, cannot bear labels with the words "bottled in bond under government supervision." Canada contends that this would force her liquor sent to this country to be bottled on this side of the border and result in heavy losses to her distillers. As a result of her representations the order, which was to have become effective on Feb. 15, has been delayed in operation for six months.

2. Canadian liquor firms whose products were sent into the United States in prohibition days contrary to law should be made to pay fines for the alleged smuggling.

Canada maintains that this would impose heavy and unjustified penalties on her distillers.

The Doughton bill would prohibit importation into the United [illegible] sign dis- [illegible] smug- [illegible] ing

COPY

Montreal, Quebec, Mar. 19, 1936

Eli Frank, Jr.
Special Assistant to the General Counsel
Room 170-A Treasury Bldg.
Washington, D. C.

There follows copy of debates requested.

United States Tariff-802. Whiskey of all types and classes, $2.50 per proof gallon.

Provided, That this provision shall not apply to any whiskey consisting in whole or in any part of distilled spirits which have not been aged in wooden containers at least four years prior to the date the whiskey is entered, or withdrawn from warehouse, for consumption.

Mr. Cahan: Could we have an explanation as to the extent to which this item will apply? It provides for the admission into the United States of whiskey of all types and classes with the following provision:

Provided, That this provision shall not apply to any whiskey consisting in whole or in any part of distilled spirits which have not been aged in wooden containers at least four years prior to the date the whiskey is entered, or withdrawn from warehouse, for consumption.

I notice, however, on page 22 of the white paper which was submitted by the Prime Minister giving the tabular statement of tariff changes resulting from the Canada-United States Agreement that item 802 of the United States Tariff Applies to whiskey, aged not less than four years in wood containers, the previous duty, being $5. per gallon and the proposed rate, $2.50 per gallon. I should like to know definitely, first, whether the item which is now under discussion, 802, applies solely and exclusively to whiskey produced in Canada and exported to the United States in wood containers, or whether it applies to the export of bottled goods as well.

Hon. W. D. Euler (Minister of Trade and Commerce): It applies to both; it must be aged at least four years.

Mr. Cahan: I notice that by a departmental ordinance or decree of the United States liquor imported in bottles cannot bear a label containing the words "Bottled in bond under Government supervision," and I understand that it has been determined in the United States that these words cannot be used on bottled goods imported even though it is stated on the label that these goods are bottled in Canada and not in the United States. It has been called to my attention that the application of this Departmental ordinance

or decree will practically preclude the export of bottled goods which have been bottled in bond under Government supervision in Canada. If that is correct it will certainly restrict to a very considerable degree the value of this item 802. Perhaps later the minister will deal with the question. This ordinance or decree, according to its terms, was to come into force on February 15 last, but I understand that, by reason of the negotiation of the Canada-United States Trade Agreement which is now under the consideration of this committee, the operation was postponed for six months. I suggest to the Minister of Trade and Commerce that unless the matter is determined now I can foresee that once this agreement is ratified by Parliament there will be little chance indeed of having that ordinance repealed, and I bring to his attention the fact that the effect of that ordinance will be to destroy the industry engaged in bottling liquors in Canada and tend to transfer that bottling industry to the United States. I am simply calling attention to this as a factor which mitigates against Canadian exporters receiving the full advantage of the agreement.

There is another matter to which I would call attention. In a bill which has already passed the House of Representatives and is now under the consideration of the Senate of the United States, section 403A provides as follows:

Whenever the Secretary of the Treasury finds that there has been instituted, or that process has been issued for the institution of, any proceeding by the United States, based upon a claim arising under the customs or internal revenue laws in connection with an alleged importation or bringing into the United States of distilled spirits, wines, or fermented malt liquors, against any person, whether or not a resident of the United States, and that such person has, or at the date of the enactment of this act had, a substantial interest, direct or indirect, in any plant, establishment, or business outside of the United States for the production, manufacture, rectification, selling, or marketing of distilled spirits, wines, or fermented malt liquors, the Secretary shall publish such information as will, in his judgment sufficiently identify such person and such plant, establishment, or business, and after such publication no distilled spirits, wines, or fermented malt liquors produced, manufactured, rectified, sold or marketed by such person, or in which he has any interest, or produced, manufactured, rectified, sold or marketed in or by any such plant, establishment or business shall be imported or brought into the United States unless and until such person submits to the jurisdiction of the court of the United States in which such proceeding has been instituted, or out of which such process has been issued, and, to secure payment of the claim, furnishes to the Secretary of the Treasury such security as he may require, but not in excess of double the amount of the claim, or complies with such other reasonable terms as he may impose.

It is well known- and I do not wish to enter into a detailed discussion of it- that the United States Treasury has preferred claims either directly or indirectly against almost every leading Canadian distillery and is seeking to impose penalties and obtain payment of a vast number of claims amounting

to many tens of millions of dollars from Canadians who are domiciled and resident in this country, and who are not subject to the jurisdiction of United States courts. This bill, which appears to me to attempt by an indirect method to obtain jurisdiction over Canadian nationals domiciled in Canada, and ove whom the United States courts would not, except for this proposed enactment, obtain jurisdiction, is one which, if enacted by the Congress of the United States, would really reduce almost to a nullity the advantages of the reduction proposed to be made in this agreement from $5 customs duty per gallon to $2.50 per gallon on Canadian whiskey entering the United States.

I do not know that I have ever drunk a glass of Canadian whiskey in my life and therefore I am not personally interested -

Mr. Jacobs: What are you waiting for?

Mr. Cahan: Well, I can find other decoctions which suit my taste better. But I commend this item and this proposed reduction, not from the point of view of the whiskey trade, but because it is one item in this agreement which will, I think, to a certain extent enable Canada to reduce the balance of trade which now and for many years has been against us in our dealings with the United States. I discussed that question once, and I am simply referring to it for this moment again. I am thoroughly convinced we cannot maintain any stable monetary policy in this country so long as we are purchasing from the United States, as we have done in years past, so many million dollars in value of their products in excess of the value of the products which we sell to them. I think that goes to the very root of our monetary and credit policy. From that point of view I commend this item to the Committee and intend to vote for it, and I would do anything I reasonably could to secure its approval by the Committee. But with that I have in my mind that, if the bill which, having already passed the House of Representatives, is now before the United States Senate, is enacted and enforced in the United States, it will almost completely wipe out any advantage which we would otherwise obtain under this item of the proposed agreement now under consideration. I would like to be assured by the Government that every reasonable measure is being taken to represent to the United States Government, and through that Government to the United States Congress, that the enactment of the bill now under consideration in the United States Senate would preclude this country taking any reasonable advantage of the item.

I do not wish to cast any aspersions, but I remember in my youthful days, under an old reciprocity agreement of many years ago, preserved fish was permitted to enter the United States free of duty, and that was followed by a United States duty on the tin cans which absolutely precluded us from doing business in that country by the export of those fish products in proper packages. I trust that, concealed beneath this item,

there is not the prospective enactment of the section of the bill to which I have called attention and which was discussed and passed by the House of Representatives on August 22, 1935, the whole bill being found at page 14120 of the Congressional Record for that date.

Mr. Euler: The references made by my honorable friend to the difficulties surrounding the export of liquor under the new and favourable rates of duty to the United States have come to the knowledge of the Government and, I may say quite frankly, have given the Government considerable concern. As the honorable Member says, if either of these two provisions, the one with regard to labeling and the other with regard to the action which is brought against the various distilleries in Canada, come into force and are applied, they will to a very great extent nullify the benefit conferred by the reduction of duty under the Trade Agreement. The Committee will understand that this is quite a serious matter, when it is realized that there is in stock in Canadian distilleries something like 25,000,000 or 35,000,000 gallons, which at a value of perhaps $6 a gallon would run to some $150,000,000 or $180,000,000. If these liquors can be exported to the United States there will be a saving at least to the Canadian exporter which would be reflected, perhaps, in the way my honorable friend suggests, and, maybe, in increased income taxes to those who make profits out of the liquor, would amount to a very large sum; possibly $75,000,000 is the amount of money that might be involved.

These two matters are not mentioned in the Agreement at all. They have developed since the Agreement was signed.

Mr. Cahan: No, no.

Mr. Euler: Perhaps I should correct that; they have come into more active discussion since the Agreement was signed.

Mr. Cahan: I think that is correct.

Mr. Euler: I will put it in that way. And, as was stated by the honorable Member, if these two or either of them come into force they will very largely nullify the benefit of the reduced rate on whiskey which we have secured.

So far as the labels are concerned, that regulation comes into force on August 15 unless it is altered. With regard to the embargo that may be placed against Canadian liquors, Canadian whiskey, unless certain action is taken by the distillers, that has not yet become law and is still a matter of consideration.

I do not know just how far I should go with regard to an expression of opinion on the part of the Government, except that it has given and is now giving the Government very considerable concern, because of the fact

mentioned by my honorable friend, that if these regulations are carried out and if this legislation is carried through it will appear, at least - I will not say that it is intentional at all - as if it were intended almost to nullify the granting of the decreased rate of duty on whiskey and to destroy that business.

With regard to this I can only say in conclusion that I think the Government of the United States is fully aware of the view which the Canadian Government takes with regard to the matter. I am not sure that I can say any more with regard to that at the moment.

Mr. Cahan: I thank the Honorable gentleman for the very explicit statement he has made. I restrained myself considerably in dealing with it -

Mr. Euler: So did I.

Mr. Cahan: - Because I realized that perhaps a prolonged discussion in this house might not facilitate the acceptance of the representations which the Government no doubt are making and will make; and having stated the case, I personally do not wish to proceed further with a discussion of it.

Mr. Mackenzie King: I should like to add just a word in reference to what the Minister has said as to this matter assuming a new importance since the Agreement has come into effect. As my Honorable friend apparently knows it is a very old issue. It is not something which has come into being just recently; it is a matter which has been under consideration by Department of the United States Government for some considerable time.

Mr. Cahan: I knew of the fact that the previous Government was aware to a certain extent of the difficulties which had arisen when this bill, of which I read one section, was introduced in the House of Representatives, and a great many people were, I think hopeful that in the course of the negotiations between the present Government and the United States Government some understanding might have been reached with regard to the final enactment of that measure.

Mr. Mackenzie King: I think my Honorable friend will find that the representations the Government have made will be helpful towards that end.

Mr. Douglas: I would like to ask the Minister whether the Government were aware at the time this agreement was signed that this legislation was passing through the House of Representatives, or had passed last August?

Mr. Euler: It is not through the Senate.

Mr. Douglas: But through the House of Representatives?

Mr. Euler: Yes.

Mr. Douglas: Would it not have been possible to provide in the new Agreement some item that would have prevented this embargo?

Mr. Euler: The Government of Canada cannot very well interfere in the domestic affairs of the United States. They have complete authority to do as they please. This Agreement was not subject to ratification; the President had complete power.

Mr. Douglas: I was not suggesting that. I was asking if it would not have been possible to have in the Canada-United States Agreement some clause which would have prevented this item from being nullified by the legislation pending.

Mr. MacKenzie King: Perhaps I might point out to my honorable friend that there is an article in the Agreement, Article XI, which is intended to meet the sort of contingency that he and possibly others may have in mind. Article XI reads:

In the event that the Government of either country adopts any measure which, even though it does not conflict with the terms of this Agreement, is considered by the Government of the other country to have the effect of nullifying or impairing any object of the Agreement, the Government which has adopted any such measure shall consider such representations and proposals as the other Government may make with a view to effecting a mutually satisfactory adjustment of the matter.

That provision has been inserted to avoid the possibility of occurrences of the kind my honorable friend has mentioned. Of course, as the Minister has just said, it is not within the province of one country to interfere in the domestic affairs of another country, and it is not for the Government of Canada to tell either the House of Representatives or the Senate of the United States what they should or should not do. Nothing of that kind could appear in any agreement; it would not be permitted to appear. But I can assure my honorable friend that with respect to this matter, as far as it affects Canadian interests, the position and the interests of Canada have been most fully represented at Washington. I have every reason to believe that such representations are being sympathetically considered, though what final action may be taken by any legislative body in the United States it is, of course impossible to say.

Sir George Perley: I am glad to hear what the Prime Minister has just said on this subject. I only want to ask now, since I understand that there is in the agreement a provision for negotiation if a clause of the Agreement is completely nullified by some other legislation, whether in case such negotiations should not be successful that would give Canada the right to terminate thi Agreement. This is a serious matter.

Mr. MacKenzie King: If any essential feature of the Agreement were impaired by some action of the United States, I should feel that, under the escape

clauses there would be opportunity for the Dominion to go the length, if need be, of rescinding the Agreement after having made the proper representations.

Item agreed to.

Lewis

1235A

Toronto Globe
March 21, 1936

CANADIAN WHISKEY TRADE THREATENED

Lawyers Seek Way to Stop Threatened Move Against Dominion Liquor in U. S.

(By William Marchington)
(Staff Correspondent of the Globe)

Ottawa, March 20.

Twoscore of the ablest lawyers in Canada are now seeking a way out of the impasse which not only threatens to cost Canadian distillers $50,000,000 in penalties for bygone infractions of the United States laws, but also jeopardizes their richest market for liquor.

May Avert Club

It is now believed by some of the legal experts that Article 7 of the Canadian Trade treaty with the United States may save the big distillers of Ontario and Quebec from the club which the American Government is swinging over their heads.

This article provides that no prohibitions, import or customs quotas, import licenses or any other form of quantitative regulation shall be imposed by the United States upon the importation or sale of Canadian products, including whiskey, which are described in schedule two of the trade agreement.

Counsel for the Canadian distillers are trying to figure out if this would prevent enforcement of legislation now before the United States Senate to empower the Secretary of the Treasury to ban the sale in the United States of liquor exported to that country by Canadian firms in the days when whiskey smuggling on the Great Lakes and the Detroit River was "big business." Tens of millions of dollars are being claimed by Uncle Sam from the Canadian distillers who helped to quench America's thirst in the "dry" days prior to 1930.

"Dry" Period Data

There is an interesting story behind this belated attempt to force the Canadian distillers to pay duty on millions of gallons of smuggled liquor. In the archives of the National Revenue Department at Ottawa there are records of all the illicit shipments to the United States. Their existence was disclosed during a prosecution launched by the Royal Canadian Mounted Police against certain Montreal distillery firms, of which the leading figures are a Jewish brotherhood bearing the name of Bronfman.

When the United States Treasury got wind of the existence of these records, it sent sleuths to Ottawa to examine them, and their work was facilitated by the Minister of National Revenue, but when word of their researches reached the ears of the liquor magnates of Canada they bestirred themselves to exercise pressure on Parliament Hill, and as a result permission to examine the records was hastily withdrawn on the ground that the information contained in them had been denied to Parliament and it would be improper to make it available to a foreign Government.

But the American Treasury officials were not disposed to forsake the hare they had started, and it is known that they have made enormous claims against some of the biggest distilleries in Canada for infractions of United States laws. They are claiming up to $100,000,000, but it may be that, in crying for the moon, they hope to get something less.

Several members of Parliament who are not interested in the whiskey trade are asking why the whole reciprocity agreement with the United States should be jeopardized to protect the fortunes of liquor interests which openly flouted the laws of a friendly neighboring country when it banned the importation of alcoholic beverages.

Representations Made.

Washington, March 20 (AP). — The Canadian Government has made representations to the United States against a bill pending in Congress which would deny entry of Canadian liquor shipped by distillers alleged to have made such shipments during prohibition. William Phillips, Acting Secretary of State, told his press conference the matter was being given careful attention by the State Department which has discussed it with the Treasury.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE March 20, 1936

TO Mrs. Klotz

FROM Mr. Oliphant

I wish you would get the following information to the Secretary at his early convenience:

1. Taylor has gotten his teeth into this Canadian thing and is doing a swell job.

2. There has been no change in substance in the situation with reference to the Canadian Liquor matter. The interest of the Canadians in maintaining the $2.50 cut on liquor duties contained in the Canadian Trade Agreement is ample to prevent the parties in Canada now protesting the proposed legislation wanting to see the Trade Agreement denounced.

3. Judge Moore has told Harrison, and Harrison is telling others that the President wants our legislation killed.

4. Our legislation will pass unless Harrison is able to say to his Committee, after the hearings are over and they are alone, that the President wants the legislation killed.

5. Phillips saw several Senators yesterday without consulting us and arranged for the hearing to go over until next Tuesday when Hull gets back. The probabilities are that the purpose of this is to enable Hull to communicate with the President, or for Hull himself to make strong representations to the Committee.

6. Phillips called me yesterday and pressed upon me the seriousness of the whole matter, implying that the Treasury was to blame. I reminded him that his Department had assured us, when the Agreement was signed, that their reading to the Canadians our statement on the proposed legislation would fully safeguard Treasury interests, otherwise we would have refused to approve the Agreement. The conversation took a turn that made it necessary for me to refer to the doubt the whole incident threw on the wisdom of continuing to purchase silver from Canada on favorable terms.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE March 21, 1936

TO The Secretary

FROM Mr. Oliphant

This statement, prepared mostly from your diary but partly from records in my office and after extended consideration by all members of the Legal Staff participating in the event at the time, may be useful to you at the present juncture.

The President telephoned me today at Annapolis asking me numerous questions about the matter. He then dictated a memorandum to Phillips, who had been talking to him, asking me at each point if his statements were accurate. In substance he told Phillips that these Canadians should be treated just like citizens of this country would be; that there had to be full assurance that these people would come into court and full guarantee that any judgments obtained would be paid. He corrected some statements Phillips had made to him and indicated the trouble about agreeing upon legislation was the Canadians repeated refusal to stick to arrangements seemingly satisfactory.

He asked me to see Phillips so we could get together, presumably on the basis stated in his memorandum to Phillips. I have arranged with Phillips to see him Monday morning—Taylor and Hester will be there too.

HLO

Coffey, J 153

March 25, 1936.

Mr. James Coffey,
9 West Main Street,
Madison, Wisconsin.

Dear Mr. Coffey:

For the Secretary of the Treasury I am acknowledging receipt of your letter of March 19th. The Secretary is out of the city at the present time, but will be back in a few days, and I shall bring your letter to his personal attention at that time.

Very truly yours,

(Signed) Herbert E. Gaston

Herbert E. Gaston,
Assistant to the Secretary.

HEGaston

4-ab

OFFICE OF
THE SECRETARY OF THE TREASURY

HEG

The Secretary is familiar with this situation. I told him some months ago that the Chicago Tribune was going to investigate the matter, and expose the whole situation. I have understood that an investigation was authorized by the President and that he was satisfied there was nothing seriously wrong. As you know, our friend down the hall has been told to make good on his accusations of misdoings in this direction or shut up. I understand he has been trying to make good on them. This may be a part of that campaign. I see Coffey has been in North Dakota.

I would be inclined to send a copy of the letter to the White House?

Upm

MR. MORGENTHAU'S OFFICE TO-

Mr. Gibbons
Miss Roche
Mr. Taylor
Mr. Oliphant
Mr. Gaston
Mr. McReynolds

= = = =

Mr. Allen
Mr. Anslinger
Mr. Bartelt
Mr. Batchelder
Mr. Bell
Mr. Berkshire
Mr. Birgfeld
Mr. Broughton
Mr. Bryan
Miss Chauncey
Miss Diamond
Mr. Graves
Mr. Greenberg
Mr. Haas
Mr. Hall
Adm. Hamlet
Mr. Hanna
Mr. Harlan
Mr. Harper
Mr. Heffelfinger
Mr. Helvering
Mr. Hester
Mr. Julian
Mr. Kilby
Mr. Lochhead
Miss Lonigan
Mr. Moran
Mr. Murphy
Mr. O'Connor
Miss O'Reilly
Adm. Peoples
Miss Reynolds
Mr. Rose
Mr. Ryan
Mr. Schoeneman
Mr. Sloan
Mr. Smith
Mr. Spangler
Miss Switzer
Mr. Thompson
Mr. Upham

What else?

JAMES COFFEY
REAL ESTATE BROKER
MADISON, WISCONSIN

9 West Main St.
March 19, 1936

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

My dear Mr. Secretary:

Reliable information came to me today that one of the great papers of Chicago has directed an investigator to come to Madison and make a thorough search of the records preparatory to an exposure of the disgraceful business record of Leo T. Crowley. He is also to get evidence that the administration has been repeatedly informed of Mr. Crowley's unfitness to hold any office of public trust. The plan is to make this exposure nation wide and it is hoped it will rival in importance the Teapot Dome case. A rumor seemingly well authenticated has it that he has been able to put public money into some of his institutions.

I knew Mr. Crowley was unfit to hold office and protested his confirmation. As a result of a request from Washington more than a year ago I sent to Mr. Farley a statement of facts. I know that many other statements have gone to Washington from Madison. I am writing this at the suggestion of friends of the administration and with the hope that you will act immediately and thereby save the President and his administration serious embarrassment.

If I can be of any further assistance, please call on me, I am

Respectfully

James Coffey

James Coffey, former Democratic State Chairman for South Dakota and Collector of Internal Revenue for the District of North & South Dakota in the Wilson administration.

JC:D

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE March 21, 1936

TO Mr. Taylor

FROM Mr. White

Subject: Principal features of the Canadian Trade Agreement.

1. Canada second largest customer of the United States.

The trade agreement with Canada is of far-reaching scope, since Canada is the second largest customer for United States exports and since the United States is the second largest market for Canadian exports. As a compensation for the binding of many free commodities by the United States, which is of great benefit to her, Canada has made reductions in duties on American commodities which represent a substantially larger value of trade than is represented by the Canadian commodities on which the United States has reduced duties.

2. Benefits for United States exports to Canada.

(a) Direct duty reductions on about 180 agricultural and industrial items -- three-fourths of the total dutiable exports to Canada from the United States.

(b) "Most-favored-foreign-nation" rates on all other commodities in place of the higher "general" rates.

(c) Relief from the Canadian system of arbitrary valuations.

(d) Benefits to commercial travelers and transit trade.

3. Concessions made by the United States to Canada.

(a) Binding on the free list of crude products such as pulpwood, newsprint, lumber, and other commodities.

(b) Reductions in duty for specified quantities of cattle, cream, seed potatoes, and lumber of Douglas fir or Western hemlock.

(c) Reductions in duty on other lumber, cheese, fish, and other items.

4. Effects on trade.

It is too soon to measure the effects of the trade agreement on the trade of the United States with Canada. Figures for the United States trade with Canada are as yet available only for the month of January. These show that exports to Canada during January 1936 were 18.2 per cent greater than in January 1935, while total exports of the United States were 12.2 per cent greater. Imports from Canada in January 1936 were 20.8 per cent greater than in January 1935, while total imports increased 12.4 per cent. These great increases in trade must not be considered an indication of the results to be expected in the future since importers and exporters in both nations held up shipments in anticipation of the lower duties which would go into effect with the trade agreement. Preliminary figures of imports of commodities under the quota provisions during January and February indicate that but 2.7 per cent of the annual quota of Douglas fir and Western hemlock, 4 per cent of the quota of cattle under 175 lbs. per head, 3.2 per cent of the quota on dairy cows, 3.3 per cent of the quota on seed potatoes, and 0 per cent of the quota on cream were filled; 14.1 per cent of the quota on cattle over 700 lbs. per head was filled. These relatively small imports reflect the seasonal character of the trade in these items.

5. Effects on customs revenue.

It is estimated that there will be no change in revenue on all the items except whisky. It is expected that increases in duty collected on cheese, cattle, and cream will counteract losses in revenue on the other items. The reduction in the duty on Scotch and Irish type whiskies will probably result in a loss of revenue of about $4 millions, while the reduction in American and Canadian type whiskies will probably result in a loss of revenue during the first year only of not more than $7,500,000. There will be no loss of revenue from Canadian and American type whiskies after 1936, since by that time domestic stocks of aged whisky will be sufficient for consumption and consequently imports will fall off in any case.

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.

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, November 11, this statement was transmitted with a covering letter from the Secretary of the Treasury to the Secretary of State.

On Thursday, November 14, at 5:45 p. m., Mr. Oliphant telephoned to Mr. Hickerson and requested information as to what steps had been taken to communicate to the appropriate representatives of the Canadian Government 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.

COPY

TELEGRAM

THE WHITE HOUSE
WASHINGTON

Executive Offices
Miami Florida
March 23, 1936

TO:

Hon William Phillips
Under-Secretary of State

I have spoken with Oliphant about the Canadian liquor matter.

Here is my suggestion as a minimum of what we should require of Canada.

FIRST, 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.

SECOND, your statement that the Treasury only had proof in one case is definitely denied by the Treasury. They have a number of cases pending but are only ready to go to trial at this time with filing one case.

I repeat what I told you the other day, that if these people were American citizens we could levy against their imports to satisfy a judgment. Therefore Canadians against

whom we obtain judgment ought to assure us that we can make collection. If the representatives of the Canadians would give better evidence to the Treasury that they would go through with a proper agreement could be made, but so far the Canadian's representatives have been a little too vague and their assurance unsatisfactory.

Franklin D. Roosevelt

COPY

March 26, 1936

MEMORANDUM

After handing Mr. Phillips a memorandum urging the desirability of a conference at the earliest possible date between the Canadian distillers and the Treasury Department, Mr. Wrong informed Mr. Phillips orally that the matter of practical assurances guaranteeing that Canadian distillers would submit to our jurisdiction in the event a settlement could be reached with the Treasury Department had also received consideration. Mr. Wrong said that it was the view of his government that it was so eminently desirable to settle these claims at once by negotiation between the Treasury Department and the distillers that they felt that every possible means should be exhausted to that end. He added that his Government had been informed by the distillers that, should it prove impossible to reach a settlement with the Treasury on the occasion of their proposed conference, the

distillers would be prepared to discuss with the Treasury the terms on which they would give practical assurances that they would submit to our jurisdiction.

John Hickerson.

WE:JDH:LMF

[COMMITTEE PRINT]

MARCH 26, 1936

74TH CONGRESS, 2d Session } HOUSE OF REPRESENTATIVES

REVENUE BILL OF 1936

REPORT OF THE SUBCOMMITTEE OF THE COMMITTEE ON WAYS AND MEANS RELATIVE TO PROPOSED TAX REVISION

This report embodies the recommendations of the subcommittee of the Ways and Means Committee to the full committee with respect to the taxation of undistributed income of corporations, elimination of the present corporation tax, termination of the capital stock tax and excess profits tax, imposition of taxes on unjust enrichment occurring as a result of the nonpayment of excise taxes, and related matters.

The recommendations submitted herewith contemplate only such changes in the Revenue Act of 1934, as amended, as are necessary to carry out the policies herein set forth. In some cases, however, in order that there may be a clear understanding of the scope of the subcommittee's proposals, a specific statement has been made that no change in the present law is proposed with respect to the particular matter.

I

TAXABLE YEARS TO WHICH APPLICABLE

The changes proposed in the present income tax (Titles I and IA of the Revenue Act of 1934, as amended) will be applicable to taxable years (whether calendar or fiscal) beginning after December 31, 1935. That is, taxpayers on a calendar year basis will first report their income under, and be subject to tax as provided in the new proposals for, the calendar year 1936 and their returns for such year will be due on or before March 15, 1937. Taxpayers on a fiscal year basis whose fiscal years begin in 1936 will similarly report and pay tax for taxable years beginning in 1936 and ending in 1937, and the returns will be due on or before 2½ months after the end of such taxable years.

II

TAX ON UNDISTRIBUTED INCOME OF CORPORATIONS

It is recommended that there be substituted for the present graduated corporation tax a tax on the income of corporations graduated according to the percentage of their income which is undistributed,

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and that for the purposes of this tax corporations be divided into two classes on the basis of the amount of their net income. The recommendations specifically are as follows:

For the purpose of the schedules hereinafter recommended the term "adjusted net income" means the net income (see recommendation No. XV relating to intercorporate dividends) less the credit allowed by section 26 of the Revenue Act of 1934 (relating to interest on Liberty Bonds and interest on obligations of Government corporations).

The term "undistributed net income" means the adjusted net income minus the sum of:

(1) Taxable dividends paid during the period beginning on the expiration of 2½ months after the beginning of the taxable year and ending on the expiration of 2½ months after the close of the taxable year (see recommendations Nos. XI, XIII, XIV, and XVIII); and

(2) The tax computed under the schedules contained in this recommendation.

The schedules proposed are as follows:

Schedule I

CORPORATIONS WITH ADJUSTED NET INCOME OF $10,000 OR LESS

If there is no undistributed net income, there shall be no tax on the adjusted net income.

If the undistributed net income is 10% of the adjusted net income, the rate of tax on the adjusted net income shall be 1%.

If the undistributed net income is 20% of the adjusted net income, the rate of tax on the adjusted net income shall be 3½%.

If the undistributed net income is 30% of the adjusted net income, the rate of tax on the adjusted net income shall be 7½%.

If the undistributed net income is 40% of the adjusted net income, the rate of tax on the adjusted net income shall be 13%.

If the undistributed net income is 50% of the adjusted net income, the rate of tax on the adjusted net income shall be 18½%.

If the undistributed net income is 60% of the adjusted net income, the rate of tax on the adjusted net income shall be 24%.

If the undistributed net income is 70% of the adjusted net income, the rate of tax on the adjusted net income shall be 29½%.

If the undistributed net income is 70.3% of the adjusted net income, the rate of tax on the adjusted net income shall be 29.7%.

Schedule II

CORPORATIONS WITH ADJUSTED NET INCOMES OF MORE THAN $10,000

If there is no undistributed net income, there shall be no tax on the adjusted net income.

If the undistributed net income is 10% of the adjusted net income, the rate of tax on the adjusted net income shall be 4%.

If the undistributed net income is 20% of the adjusted net income, the rate of tax on the adjusted net income shall be 9%.

If the undistributed net income is 30% of the adjusted net income, the rate of tax on the adjusted net income shall be 15%.

If the undistributed net income is 40% of the adjusted net income, the rate of tax on the adjusted net income shall be 25%.

If the undistributed net income is 50% of the adjusted net income, the rate of tax on the adjusted net income shall be 35%.

If the undistributed net income is 57½% of the adjusted net income, the rate of tax on the adjusted net income shall be 42½%.

If the percentage which the undistributed net income is of the adjusted net income is not one of the percentages of the adjusted net income shown in Schedule I or II, then the rate of tax shall be proportionate.

If the adjusted net income is more than $10,000 the tax, at the option of the corporation, shall, in lieu of being computed under Schedule II, be computed by adding:

(1) A tax upon the adjusted net income computed under Schedule I; and

(2) A tax upon the amount of the adjusted net income in excess of $10,000, at the rate in Schedule II which would be applied if the tax were being computed solely under such Schedule.

III

EXEMPTION OF BANKS

It is recommended that incorporated banks and trust companies bona fide operated as such be exempted from the plan proposed under recommendation No. II and be subject to a tax of 15% on the net income (see recommendation No. XV relating to intercorporate dividends) in lieu of the present graduated corporation tax. It is further recommended that banks continue to be subject to section 102 of the Revenue Act of 1934 relating to accumulation of surplus to avoid surtax.

The subcommittee leaves to the full committee as an unsettled question whether dividends paid by banks to shareholders, individual or corporate, should be treated under the present law or whether they should be fully taxable like dividends paid by other corporations.

IV

TREATMENT OF INSURANCE COMPANIES

It is recommended that all bona fide insurance companies (mutual and stock, foreign and domestic) be exempted from the plan proposed under recommendation No. II and be subject to a tax of 15% 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% in lieu of the graduated rates under existing law.

It is recommended that dividends received by all insurance companies be treated the same as dividends received by other corporations (see recommendation No. XV).

V

CORPORATIONS IN RECEIVERSHIP

It is recommended that corporations in receivership be exempt from the plan proposed under recommendation No. II and be subject to a tax of 15% in lieu of the graduated rates under existing law.

Dividends received by such corporations shall be included in net income, and dividends paid by them shall be subject to tax in the hands of the shareholder as in the case of dividends paid by other corporations.

VI

FOREIGN CORPORATIONS

It is recommended that foreign corporations be exempt from the plan proposed under recommendation No. II and be subject to a tax of 22½% instead of the rate under existing law, accompanied by a change in the rate on withholding under existing law to 22½%.

VII

RAILROADS

It is recommended that railroads be subject to the plan proposed under recommendation No. II and the privilege of filing consolidated returns be continued as to them, the rate of tax to be the same as in the case of other corporations under recommendation No. II; but with the right to make a new election whether or not to file a consolidated return for their first taxable year under the new law.

If in the affiliated group the parent corporation is in receivership the entire group shall be taxed as other corporations in receivership (see recommendation No. V). If any other member of the group is in receivership it does not gain the exemption referred to in recommendation No. V.

VIII

EXEMPT CORPORATIONS GENERALLY

It is recommended that corporations now exempt from income tax under section 101 of the Revenue Act of 1934 (labor, agricultural, charitable, and other nonprofit corporations), be exempt from the new plan and from the corporation tax under existing law.

IX

CAPITAL STOCK TAX

The rate of capital stock tax imposed by section 105 of the Revenue Act of 1935 is proposed to be reduced to 70 cents per $1000 of the adjusted declared value for the capital stock tax year ending June 30, 1936. This constitutes a substitution of a 70-cent rate for a $1.40 rate. The tax is proposed to be terminated for all later years.

X

EXCESS PROFITS TAX

The excess profits tax imposed by section 106 of the Revenue Act of 1935 is proposed to be terminated at the end of the first income tax taxable year of the taxpayer which ends after June 30, 1936. The rate is not changed. Corporations whose income tax taxable years are on a calendar year basis will be subject to this tax for the calendar year 1936. Corporations whose income tax taxable years are on a

fiscal year basis, which years end after June 30, 1936, will be subject to that tax for the first income tax taxable year ending after such date. The tax will not apply to any income tax taxable year which ends after June 30, 1937.

XI

DIVIDEND CARRY-OVER

It is recommended that if the taxable dividends paid during the period beginning on the expiration of 2½ months after the beginning of the taxable year and ending on the expiration of 2½ months after the close of the taxable year are in excess of the adjusted net income for the taxable year, the excess (or if there is no adjusted net income, the entire amount of the taxable dividends) shall be allowable as a deduction in computing the undistributed net income for the succeeding taxable year, and, to the extent not needed to reduce the tax in such year (after first applying as a deduction any more recent dividend payments), then in the second succeeding taxable year.

XII

DIVIDENDS IN KIND

In computing undistributed net income, if a corporation declares a dividend in kind, the deduction will be computed at market or at the adjusted basis in the hands of the corporation, whichever is lower.

XIII

DIVIDENDS OUT OF PRE-MARCH 1, 1913, SURPLUS

It is recommended that dividends paid out of earnings and profits accrued before March 1, 1913, or out of increase in value accrued before March 1, 1913, be fully taxable when distributed.

XIV

NORMAL TAX ON DIVIDENDS

It is recommended that the present credit, allowed for normal tax purposes, of dividends received shall be abolished, so that all dividends will be subject to normal tax as well as to surtax.

XV

INTERCORPORATE DIVIDENDS

It is recommended that the present deduction allowed corporations for dividends received from other corporations be abolished, so that intercorporate dividends will remain in net income.

XVI

DIVIDENDS OUT OF PRE-1936 EARNINGS

It is recommended that dividends out of earnings and profits accumulated prior to the beginning of the first taxable year of the corporation under the new plan shall when declared out as dividends be fully taxable as in the case of the distribution of subsequent earnings and profits.

XVII

DIVIDENDS OUT OF EARNINGS TAXED UNDER NEW PLAN

It is recommended that no exemption from tax on the shareholder be given to dividends declared out of earnings and profits of a year in which the corporation has been subject to taxation under the new plan recommended under recommendation No. II.

XVIII

LIQUIDATING DIVIDENDS

In computing undistributed net income, it is recommended that the corporation be allowed a deduction for any part of liquidating dividends properly allocable to earnings and profits, but no deduction shall be given for the portion thereof properly chargeable to capital account.

XIX

NET INCOME IN EXCESS OF ACCUMULATED EARNINGS AND PROFITS

It is recommended that relief be provided for the corporation which, while having an adjusted net income for the taxable year, lacks sufficient accumulated earnings and profits as of the close of the taxable year from which to distribute taxable dividends equal to the adjusted net income. For example:

(1) A corporation may have an adjusted net income of $100,000, but a deficit, carried over from prior years, of $150,000. Any distribution by the corporation could not be out of accumulated earnings and profits, would not be taxable as a dividend to the shareholders, and hence, under the rule previously recommended (see definition of "undistributed net income" in recommendation No. II), would not be deductible by the corporation from adjusted net income in computing undistributed net income. Therefore, even if an amount equal to the adjusted net income were distributed, the tax on the corporation would be the same as if no distribution were made.

(2) A similar hardship would exist where the net adjusted income is $100,000, with a prior deficit of $60,000. Here the maximum taxable dividend would be $40,000, and $60,000 would, even if distributed, be taxable to the corporation as if not distributed.

(3) Even if no deficit exists, hardship may exist where the earned surplus at the beginning of the taxable year is not enough to meet a nondeductible loss occurring during the year. Thus suppose the accumulated earnings and profits at the beginning of the year are $1,000, the adjusted net income $100,000, but a capital net loss of $40,000 has been sustained. The earnings and profits for the year are only $60,000, making the total accumulated earnings and profits $61,000. Therefore, without relief, the corporation must pay tax on $39,000 even if it distributes $100,000, an amount equal to the entire adjusted net income.

The relief recommended is as follows:

If the accumulated earnings and profits of the corporation as of the close of the taxable year (computed without diminution by reason of the distribution during the taxable year of earnings and profits) are less than the adjusted net income, the tax shall, in lieu of being computed under the schedules usually applicable, be computed by adding:

(a) a tax of 22½ per centum of the excess of the adjusted net income over the accumulated earnings and profits as of the close of the taxable year; and

(b) a tax upon the remainder of the adjusted net income in accordance with the schedule (see recommendation No. II) applicable to an adjusted net income equal to the amount of such remainder.

It should be provided that this provision shall in no case operate to increase the tax that would be payable without its application.

The effect of the recommended plan upon the examples above given is as follows:

Example No. 1: The tax would be 22½ per centum of the entire adjusted net income.

Example No. 2: The tax would be 22½ per centum of $60,000 plus the tax on $40,000 in accordance with the applicable schedule.

Example No. 3: The tax would be 22½ per centum of $39,000 plus the tax on $61,000 according to the applicable schedule.

XX

CONTRACTS NOT TO PAY DIVIDENDS

It is recommended 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 22½% on the part of the adjusted net income which equals the earnings and profits which it is prohibited by the contract from using for the payment of dividends, and on the remainder of the adjusted net income, if any, shall be taxed at the rates applicable under the appropriate schedule applicable to an adjusted net income equal to such remainder. It should be provided this provision shall in no case operate to increase the tax that would be payable without its application.

XXI

CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

Section 102 of the Revenue Act of 1934 is proposed to be made inapplicable except to banks, insurance companies exempt from the new graduated rate on undistributed net income, and foreign corporations.

XXII

PERSONAL HOLDING COMPANIES

Section 351 of the Revenue Act of 1934, as amended, is proposed to be made inapplicable to taxable years beginning after December 31, 1935.

XXIII

NON-RESIDENT ALIENS

It is recommended that no change be made in the normal tax and surtax of non-resident alien individuals but that the rate of withholding at the source under existing law be increased to 22½%; any overpayment of tax resulting therefrom to be refunded.

It is recommended that the Commissioner of Internal Revenue be given authority by regulations to exempt from withholding salaries and wages of non-resident alien individuals who go back and forth at frequent intervals.

XXIV

WINDFALL TAX

It is recommended that a tax at the rate of 90 per cent be imposed on unjust enrichment accruing to any person from shifting to others the burden of Federal excise taxes. This tax would apply to two classes of persons—

(1) Those who were supposedly liable for the tax and shifted its burden to others, but who did not pay the tax or who paid it and obtained a refund, and

(2) 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.

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.

In the second class, the tax would be computed as follows: The net income of the taxpayer arising from reimbursement to him by his vendors for excise tax burdens borne by him in the purchase of the articles would be computed. The extent to which he had passed the tax on to his customers would then be determined. The tax would apply to the part of the net reimbursement which represents the amount of tax burden passed on to the customers.

The term "Federal excise tax" should be defined for such purposes to include all Federal internal revenue taxes with respect to articles and commodities, whether valid or invalid.

The proposed tax should apply retroactively to all income tax taxable years ending during the calendar year 1935 and to all subsequent taxable years. It will thus cover the cases of unjust enrichment arising as a result of the recent impounding and non-payment of processing taxes.

The net income in the categories specified above must be determined by the allocation of the proper deductions from the gross income arising in those categories, under rules and regulations in accordance with a general standard laid down by the bill.

It is suggested that a prima-facie rule be established for determining the extent to which the taxpayer shifted the excise tax burden to others. This can be accomplished by the comparison of the gross profit margin of the taxpayer with respect to the articles in question against the average gross profit margin of the taxpayer with respect to such articles during a representative period of two years preceding the initial imposition of the Federal excise tax. The gross profit margin would be the difference between the selling price of the articles and the cost of the raw materials entering into those articles, exclusive of indirect and overhead costs. 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 exceeded his gross profit margin during the representative period preceding the tax. 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. Allowance might also be made for lawyers' fees and expenses of litigation incurred in obtaining refund or preventing collection of the tax, or (in the case of the middleman) in obtaining reimbursement from the vendor for the tax burden. It is suggested, however, that the allowance of these fees and expenses be limited to 15 percent of the amount involved in the litigation.

Provision must also be made for the establishment of true costs and selling prices where the taxpayer has dealt through an affiliated corporation.

The above rules for determining the extent to which the tax burden was shifted should, of course, merely establish a presumption. 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. The bill should also provide for the consideration of proof that the taxpayer modified his contracts of sale to reflect the initiation, termination, or change in amount of the excise tax, or at such times changed his sale price, by substantially the amount of the tax or the change therein, or at any time billed the tax as a separate item to any vendee, or at any time indicated by any writing that his sale price included the amount of the tax, but should provide that the taxpayer may establish that such acts are not properly to be considered in connection with the particular sales in question.

Provision should be made against double taxation of the income subject to the proposed tax by the exclusion of the amount of income upon which the proposed tax is based from the computation of any other income tax on the taxpayer. Special provision will have to be made for returns in the case of taxable years which ended prior to the enactment of the bill.

XXV

FLOOR STOCKS TAX

The subcommittee recommends that appropriate provisions be enacted which will place all holders of floor stocks except the first domestic processor of articles processed from commodities subject to the processing tax on January 6, 1936, in substantially the same position they would have occupied had the processing taxes been terminated by proclamation by the Secretary of Agriculture in the manner provided by the Agricultural Adjustment Act.

The Agricultural Adjustment Act provided for a floor stocks tax on the effective date of the processing tax so that all articles, the product of the commodity subject to the processing tax, would move into channels of trade equally taxed. That act likewise provided for a refund upon termination of the tax to holders of floor stocks with certain limitations so that, in the main, articles on hand on that date and articles subsequently processed would also move into channels of trade, this time equally untaxed. Certain inequities have resulted from termination of that tax which require special treatment. The Committee feels that this result can be accomplished by appropriate legislation providing for refunds to holders of floor stocks on January 6, 1936 without proof of payment of the processing tax by the processor to the government. If the tax was not actually paid, any resultant advantage to the processor will be taken care of by the windfall income tax which is being recommended. The subcommittee feels, however, that this refund should be limited in amount to the amount by which the price of the finished article was reduced after the effective time of this floor stocks refund provision. Since the suggested remedial provision is not one required by law but is for the purpose of fair dealing, it is believed that the Commissioner's determination should be final and not subject to administrative or judicial review. In addition, because of the cost of handling such claims, both to claimants and to the government, we believe that a minimum limitation of $10.00 should be placed upon such claims. A similar provision was contained in the floor stocks provision of the Agricultural Adjustment Act.

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of the Public Debt Service, where the necessary number of Vete

TREASURY DEPARTMENT

Washington

FOR IMMEDIATE RELEASE
Friday, March 27, 1936.

Press Service
No. 7-9

Shipments of Adjusted Service Bonds are going forward to Federal Reserve banks from the Treasury, Acting Secretary Taylor announced today, in preparation for the disbursement of bonds and checks to veterans in payment of Adjusted Service Certificates, as provided by the Adjusted Compensation Payment Act, 1936.

Shipment was begun on receipt from the Veterans' Administration of the first of the vouchers listing the names of veterans and the amounts due to them under the act.

The Treasury Department has completed its arrangements for the actual disbursement to veterans beginning on June 15 and continuing until all claims have been paid. Disbursement to veterans having residence in the Fifth Federal Reserve District (the Richmond district) and to those whose certificates are held at Veterans' headquarters in Washington, will be made direct from the Treasury Department in Washington. All others will be handled by regional disbursing offices of the Treasury and Federal Reserve Banks in the remaining eleven districts.

The vouchers listing payments to be made will go first to the various Treasury disbursing offices, where in each case a check will be written for the amount by which the payment exceeds an amount evenly divisible by $50. The lists will then be delivered to the Federal Reserve Bank or, in the case of the Washington, D.C. lists, to the Division of Loans and Currency of the Public Debt Service, where the necessary number of Veterans' Bonds,

each in the denomination of $50, will be made out in the name of the veteran. Each veteran will receive a Government check and the number of $50 bonds necessary to make up the full amount due him. For instance, a veteran having an approved claim of $763.50 will receive a check for $13.50 and fifteen $50 bonds. These bonds mature in 1945, but are payable at any time at the will of the owner. They will earn 3 percent interest for the veteran for as long as they are held up to maturity, but no interest will be paid if they are cashed within the first year.

Delivery of bonds and checks to the veterans will be made by registered mail, the first mailing to be made on June 15 of this year.

COPY

March 28, 1936

My dear Mr. Secretary:

The Department has considered a copy of the memorandum left with the Under Secretary of State on March 26, 1936, by Mr. Hume Wrong, Canadian Charge d'Affaires, with reference to the legislation now pending in the Senate which would have the effect of imposing certain limitations upon the importation of liquor from Canada. It has also considered a copy of Mr. Hickerson's memorandum of March 26, 1936, setting forth the statements made verbally by Mr. Wrong at the time of the delivery of the Canadian memorandum.

As regards the specific suggestions set forth in the memoranda, it will be recalled that the President, in his telegram of March 23, 1936, to Under Secretary Phillips, indicated that, as a minimum, the Canadian Government should be required to give the practical assurances of the Canadian companies not only that they would submit to the jurisdiction of our courts, but also, to quote his words, that they give "practical assurance ..... that any judgment which may be obtained against them will be paid." The memoranda of the Canadian Government made no reference to practical assurances of the latter sort. The Canadian Government refers to the possibility of negotiations or conferences looking to compromise or settlement. The Department, however, cannot under-

take to enter into discussions directed to compromise or settlement, and no reference thereto is made by the President in his instructions.

If practical assurances of the two sorts mentioned by the President can in fact be given the Treasury will be glad to discuss this two-fold matter. The Department must insist, however, that, if these companies propose to hold such a conference they do so at once for the Department cannot jeopardize the pending legislation by further delay.

Yours very truly,

/S/ Wayne C. Taylor
Acting Secretary

The Honorable
The Secretary of State
Washington, D. C.

SK:L

STRICTLY CONFIDENTIAL

March 28, 1936.

REPORT

To: The Executive Committee on Commercial Policy

From: Subcommittee on Countervailing Duties in Relation to Currency Problems

The Subcommittee on Countervailing Duties in Relation to Currency Problems, set up by the Executive Committee on Commercial Policy at its meeting of February 28, was assigned the task of examining the application of countervailing duties to imports from countries which employ special currency arrangements in connection with their foreign trade. The problem arose in connection with plans formulated at the Treasury Department for countervailing action with respect to certain goods imported from Germany, Hungary, and Latvia, alleged to be subject to countervailing duties by reason of the currency procedures involved in their marketing in this country. These plans were referred to the Executive Committee for comment, and the Committee instructed this subcommittee to submit a report, dealing not only with the three specific cases, but also with the whole problem of the relation of currency depreciation or manipulation to possible countervailing action on the part of our Government.

The briefness of the period of time at the disposal of the subcommittee precluded the possibility of as extensive and thorough an investigation as the highly technical and complicated nature of the problem would well warrant. The subcommittee is compelled to content itself with the following observations, which, however, it believes to be substantially adequate to support the suggestions and recommendations made in this report.

I. Types of Currency Measures Involved

In examining the problem placed before it, the subcommittee found it necessary, first of all, to review the various types of currency measures which are pertinent to this discussion. Generally speaking, these measures fall into the following three categories:

1. Currency devaluation, which occurs when a country alters definitively or provisionally the gold content of its basic monetary unit;

2. Currency depreciation, which occurs when a country openly permits its basic monetary unit to find a new foreign exchange level in all international transactions, with or without governmental intervention in the foreign exchange market;

3. Currency manipulation, representing special types of arrangements which occur when a country, in connection with a system of foreign exchange control, permits its basic monetary unit to depreciate, in all or some international transactions, in fact, though not in name.

A country which adopts the first or the second of these types of measures does not depart from a single currenty system in the sense that it continues to have a single rate of exchange with respect to each foreign country operating on the basis of a single currency. On the other hand, a country which adopts measures of the third type may or may not continue to operate on the basis of a single currency. Frequently, the control devices give rise to a multiple currency system and, therefore, to a number of exchange rates which may differ as between various foreign currencies and between various types of transactions.

When a country's currency becomes subject to devaluation or depreciation, the terms of commercial competition between such a country and other countries are immediately altered. Since each unit of foreign currency comes to represent more units of the domestic currency in the country with devalued or depreciated currency, the exports of such a country can be offered at lower prices in terms of other countries' currencies than was formerly the case, and yet yield the exporter the same or a larger number of domestic currency units. At the same time, imported goods become relatively more expensive in terms of domestic

currency.

currency. Hence, generally speaking, devaluation or depreciation leads to the promotion of exports and an obstruction of imports, which continue until the effects of devaluation or depreciation are counteracted by price adjustments.

The imposition of a system of foreign exchange control does not alter the terms of commercial competition on the basis of which exporters in a country imposing control sell their goods abroad so long as the controlled currency unit is maintained at its pre-existing parity. An alteration in the terms of competition occurs either when international transactions escape control and lead to a de facto depreciation or when exchange control is exercised in such a way as either to recognize a de facto depreciation that has already taken place outside of government control or to cause the controlled currency unit to become depreciated in its exchange value. This latter condition usually occurs when a pre-existing parity continues to be officially maintained, but a system is set up under which exporters are permitted to obtain a higher rate or rates in the conversion into domestic currency of the foreign currencies procured by them as the proceeds of their export sales. The obtaining of such higher rates is typically accompanied by a requirement that importers pay higher rates for foreign currencies procured by them for the purpose of paying for their foreign purchases, although, as will be seen below, this is not always the case. It is a situation of this sort that gives rise to a multiple currency system.

There are in use today numerous variants of the multiple currency system, some typical examples of which may be summarized as follows:

1. Germany is the outstanding example of a country which continues to maintain its currency unit officially at its legal parity but in which international commercial transactions may take place either on the basis of such undepreciated currency or on the basis of a varying measure of depreciation. The Government has complete control over all foreign exchange transactions and, therefore, the character of the currency arrangements involved in any particular transaction is under its control. The following are the principal devices by means of which German exporters are enabled to market their goods abroad in depreciated marks:

(a) With the approval of the control authorities, German exporters may enter into barter deals with foreigners

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and, through the terms of the exchange of goods, fix by agreement, for the purposes of the particular transaction, a rate of exchange as between the mark and the foreign currency unit involved which would represent a depreciation of the mark as compared with the official rate of exchange.

(b) A special system of so-called ASKI marks has been established by the German Government. This system represents a more generalized scheme of barter transactions. Aski accounts are special reichsmark accounts set up with the permission of the exchange control authorities in the name of a foreign bank, business firm or person, into which mark payments for certain specified types of foreign goods imported into Germany may be made by any German importer without further permission, and from which the foreign account owner may, also without further permission, pay for certain delimited types of German goods for exportation. American holders of Aski deposits may dispose of them by sale to persons interested in importing goods from Germany and they are in fact quoted at a considerable discount from the official rate of exchange. Only certain types of imports from the United States are allowed to be paid for in Aski marks, which are then available for paying for a considerable range of German products. Within these limits as to quantity and within the limitation imposed by the extent of the discount at which Aski marks can be sold, the Aski marks are a regularly quoted depreciated mark currency for conducting international trade between Germany and the United States.

(c) There are in Germany different accounts frozen in the German banks as a result of the exchange control system which prevents the transfer of the funds involved to the foreign creditors except under conditions prescribed by the control authorities. These blocked marks may, by permission of the control authorities, become available for payment with respect to German exports at exchange rates representing varying degrees of depreciation as compared with the official rate of exchange. In other words, a foreign importer, by using blocked marks in making his payment to the German exporter, is enabled to place a certain number of marks at the latter's disposal with a smaller outlay in his own currency than would have been required if he were to place the same number of marks at the disposal of the German exporter on the basis of the official rate of exchange. Quotations on the different types of blocked marks can be obtained by any interested person in New York.

(d)

(d) Under the exchange control regulations, a German exporter is obligated to deliver the foreign exchange proceeds of his transactions to the control authorities. He may, however, be permitted to retain a portion of his foreign exchange proceeds and employ the funds for the purchase of German bonds in foreign markets, which he is enabled to resell in the domestic market, where quotations for similar obligations are usually higher than they are abroad. Taking the trade and the bond operations together, the entire transaction takes place in part on the basis of what amounts to depreciated marks.

(e) Under the transfer moratorium applied to German long-term obligations, only a part of the current interest payments has been transferred to the foreign creditor in foreign currencies. The remainder has been paid in scrip. The German Gold Discount Bank has been made an agency to purchase such scrip. A German exporter may be permitted to use a part of his proceeds of foreign exchange to buy through this bank, at a discount, a corresponding amount of scrip, which is then redeemed by the Government in marks at its face value. In this case, as in the case of blocked marks, the purchase of the scrip takes place on the basis of partial depreciation of the mark.

All of these opportunities for obtaining a higher rate in marks in the conversion of foreign currencies obtained by a German exporter may apply to the entire transaction or only to a part of the transaction. Moreover, the types of goods in connection with which the various procedures may be used are strictly controlled. Generally speaking, the various devices appear to be operated in such a way as to enable the German exporter to sell his goods abroad at prices prevailing in the foreign markets in terms of the national currencies of those markets, which he is not able to do except on the basis of depreciated marks.

2. Latvia is another example of a country which continues to maintain its currency unit officially at its legal parity but which permits some international commercial transactions to take place on the basis of a depreciation of its currency unit. Payment for imports may be made only by permission of the Foreign Exchange Commission. In general, importers who have received permission to make a remittance abroad are enabled to buy foreign exchange from the Bank of Latvia or from a private bank at the official rate of exchange. In some cases, however, import permits contain what is known as

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the "export clause", which entitles the holder to purchase foreign exchange directly from an exporter. The transaction must be made with an exporter who has likewise received permission to sell exchange, since otherwise the exporter would be required to surrender his exchange to the Bank of Latvia. Exchange obtained in this manner is known as "export valuta." The procedure, which is essentially one of barter, takes place on the basis of a higher rate in Latvian currency than the official rate and thus represents a depreciation of the Latvian currency unit in the particular transactions involved.

3. In a number of countries, notably some in South America, a system exists under which two definite legal exchange rates prevail. One is the official rate at which foreign currencies are bought and sold by the exchange control authorities and which may represent either the legal or a depreciated parity. The other is a free rate which is fixed more or less by supply and demand in the exchange market and which usually represents some degree of depreciation as compared with the official rate.

Under these conditions, an exporter receives a higher rate of exchange for the foreign currencies obtained by him as a result of his sales abroad to the extent that he is permitted to dispose of such currencies in the free market.

4. Hungary, Austria and Rumania are examples of countries in which the maintenance of the legal parity is a pure fiction. Under the operation of foreign exchange control, purchases and sales of foreign currencies in each of these countries are regulated by the government, but a uniform higher rate is paid in the purchase of each foreign currency and a corresponding higher rate is charged in the sale of each foreign currency.

Hungary, in addition, also maintains a system of blocked currencies operating in the same way as in Germany. Such blocked pengö, when used in payment for Hungarian exports, may represent a greater degree of depreciation than that represented by the uniform higher rate used by the National Bank. In all three countries, special exchange rates are used for barter transactions and in connection with clearing agreements.

Thus what happens under a multiple currency system is that for the purposes of the particular transactions involved, the currency of the exporting country may be considered as depreciated in exactly the same way as it would have been if the country had operated on the basis of complete and openly announced depreciation. Currency manipulation is in effect a condition of controlled depreciation and may serve either as a transitorial procedure to open depreciation and final devaluation, or as a temporary device for avoiding a permanent alteration in the monetary system.

II. Currency Measures and Countervailing Action

The legal basis in the United States for the imposition of countervailing duties is Section 303 of the Tariff Act of 1930, which reads as follows:

> Whenever any country, dependency, colony, province, or other political subdivision of government, person, partnership, association, cartel, or corporation shall pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export of any article or merchandise manufactured or produced in such country, dependency, colony, province, or other political subdivision of government, and such article or merchandise is dutiable under the provisions of this Act, then upon the importation of any such article or merchandise into the United States, whether the same shall be imported directly from the country of production or otherwise, and whether such article or merchandise is imported in the same condition as when exported from the country of production or has been changed in condition by remanufacture or otherwise, there shall be levied and paid, in all such cases, in addition to the duties otherwise imposed by this Act, an additional duty equal to the net amount of such bounty or grant, however the same be paid or bestowed. The Secretary of the Treasury shall from time to time ascertain and determine, or estimate, the net amount of each such bounty or grant, and shall declare the net amount so determined or estimated. The Secretary of the Treasury shall make all regulations he may deem necessary for the identification of such articles and merchandise and for the assessment and collection of such additional duties.

The administration of Section 303 divides itself ordinarily into two phases, described by the Treasury Department as follows:

> It is first necessary that the Secretary of the Treasury be satisfied that a bounty or grant is being paid or bestowed, directly or indirectly, upon the manufacture or production or export of any article or merchandise manufactured or produced in a foreign country and subject to ordinary duty when imported into the United States. If this fact is established, it then becomes incumbent upon the Secretary of the Treasury thereafter from time to time to ascertain and determine or estimate the net amount of each such bounty or grant and to declare the net amount so determined or estimated.

Action

Action under Section 303 is thus mandatory, once the fact of payment or bestowal of a bounty or grant has been established. But there is clearly a wide margin for interpretation in the establishment of this fact, especially with respect to such devices and arrangements as the various currency measures described in the preceding section of this report, which, because of their comparatively recent origin, could scarcely have been aimed at, directly and explicitly, by the framers of the Section.

Experience and precedent are lacking as a guide in considering whether or not such currency measures come within the scope of the "bounty or grant" concept embodied in Section 303. According to data supplied to the subcommittee by the Department of Commerce, there appear to be very few instances in foreign countries in which special measures have been taken to offset intensified competition resulting from currency devaluation, depreciation, or manipulation. Specific provisions authorizing the imposition of special duties to counteract currency depreciation are found in the legislation of a number of countries in Europe and in the British Empire, and during the period immediately following the abandonment of the gold standard by Great Britain, several countries--notably, France, Canada, and the Union of South Africa--imposed "depreciated currency surtaxes." However, such surtaxes have since been removed or moderated against most countries. There is no evidence that any special measures have been taken by any country against the manipulation of currencies under multiple currency systems. So far as the subcommittee has been able to ascertain, no counter-action has ever been taken in the United States against any form of currency measures in other countries.

In formulating its plans for the imposition of countervailing duties against certain imports from Germany and other countries on the ground of currency manipulation by these countries, the Treasury Department appears to have been guided by two decisions of the Supreme Court of the United States, which are believed to throw considerable light upon the purpose and the scope of our countervailing duty legislation. A Treasury statement on this subject gives the following excerpts from these decisions:

> The plain, explicit, and unequivocal purpose of this section is that whenever a foreign power or dependency or any political subdivision of a government shall give any aid or any advantage to exporters of goods imported into this country therefrom, whereby

they

they may be sold for less in competition with our domestic goods, the duties on them shall be increased to that extent. It is the result of such aid or advantage that Congress seeks to countervail, regardless of whatever name or in whatever manner or form or for whatever purpose it was given. Whether the thing done be called "allowance," "bonification," "bounty," "grant," "drawback," or what, matters not. The question is whether or not the result would be to admit the merchandise to our markets at a lower cost price.

Whenever any country "shall pay or bestow, directly or indirectly, any bounty or grant upon the exportation of any article or merchandise," there shall be levied and paid upon it, upon importation, in addition to the regular duty, an additional one "equal to the net amount of such bounty or grant, however, the same be paid or bestowed." The statute was addressed to a condition and its words must be considered as intending to define it, and all of them "grant" as well as "bounty"—must be given effect. If the word "bounty" has a limited sense the word "grant" has not. A word of broader significance than "grant" could not have been used. Like its synonyms "give" and "bestow," it expresses a concession, the conferring of something by one person upon another. And if the "something" be conferred by a country "upon the exportation of any article or merchandise" a countervailing duty is required by Paragraph E.

It is a protective measure, and is intended to cover every case where by the laws of a foreign country the exporter is given, either directly or indirectly, a pecuniary benefit from the exportation, whether by way of a direct bounty paid from the public treasury, by the remission of taxes, or by exemption from taxes which would otherwise be imposed on the article. - Downs v. U.S. [Md. 1902] 113 F. 144, 51 C.C.A. 100, affirmed [1903] 23 S. Ct. 322, 187 U.S. 496, 47 L. Ed. 275, (construing the Act of 1897).

We have the fact of spirits able to be sold cheaper in the United States than in the place of their production, and this the result of an act of government because of the destination of the spirits being a foreign market. For that situation Paragraph E was intended to provide. - Nicholas & Co. v. U.S. [1916] 7 Ct. Cust. App. 97, certiorari granted, Nichols & Co. v. U.S. [1916] 37 S. Ct. 113, 242 U.S. 641, 61 L. Ed. 541, and affirmed Nicholas & Co. v. U.S. [1919] 39 S. Ct. 218, 249 U.S. 34, 63 L. Ed. 461, (construing the Act of 1913).

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In commenting upon the application of these two decisions to the German case, the Treasury statement says:

> It is true that in both of the cases cited the Government actually paid something to the exporter, whereas in the instant case (Germany) the Government does not make any direct payment, and that, in these circumstances, it does not pay a bounty. On the other hand, it does bestow upon the exporter a grant or privilege susceptible of definite and certain appraisement with respect to value in money and with respect to the effect upon the competition of the foreign goods with domestic goods in our markets.

The subcommittee concurs in the opinion that the currency measures under consideration here do not involve the payment or bestowal of a bounty. The question, therefore, is whether or not such measures constitute the bestowal of a grant within the meaning of Section 303.

The interpretation of the word "grant", suggested by the Treasury's statement just quoted, especially with the introduction of the word "privilege" as a synonym of the word "grant", is unquestionably broad enough to include any and all of the currency procedures described in the preceding section of this report. An overnight devaluation of a currency or the creation of conditions under which a depreciation of a currency unit takes place are governmental acts which enable all exporters in a country taking such measures to market their goods abroad at lower prices in terms of foreign currencies and yet to receive the same or a larger return in terms of the domestic currency. Hence, devaluation, and especially depreciation, may be regarded as the bestowal upon each individual exporter of "a grant or privilege susceptible of definite and certain appraisement with respect to value in money and with respect to the effect upon the competition of foreign goods with domestic goods in our market."

Since the Treasury Department has never invoked countervailing duties in cases of complete depreciation and does not appear to contemplate such action at the present time, the subcommittee feels justified in assuming that the interpretation cited above is not intended to cover cases of complete depreciation. The real crux of the problem is, therefore, whether or not currency manipulation resulting from the use of a multiple currency system is so different in character and effect from a complete depreciation as to require countervailing action under an

interpretation

interpretation of the term "grant" which does not require the application of such action in the case of complete depreciation.

The Treasury Department clearly believes that such a difference exists. The subcommittee, on the other hand, believes that currency manipulation should be regarded as a special case of currency depreciation and that there is, by reason of that fact, no essential difference, from the point of view of the application of Section 303, between depreciation and manipulation.

In the case of currency manipulation in which the nominal parity has become a pure fiction so far as actual foreign exchange operations are concerned, there is clearly no reason for distinguishing between that situation and the one which obtains when an open depreciation takes place. The problem is more complicated where a rate of exchange based upon the nominal parity operates side by side with other rates of exchange, reflecting varying degrees of depreciation, and a situation is, therefore, created in which certain exporters are enabled to use a rate of exchange which is more advantageous to them than the rate of exchange used by other exporters.

In this connection, the subcommittee believes that the provisions of Section 303 should be properly interpreted as applying to actions affecting individual commodities rather than to general conditions. From the point of view of what happens to trade in an individual export commodity, the same effect is produced by complete depreciation applying to all exporters and by manipulation applying to selected exporters. In each case, the exporter of the individual commodity derives a competitive advantage in the foreign market and a monetary advantage in the conversion of the proceeds of his sales into the domestic currency.

It is true that in the case of currency depreciation, the amount of the advantage derived by the exporter is determined by the market rate of exchange, once the government permits the rate to be so determined, whereas under manipulation it is usually determined by governmental control over the rate of exchange. But if the test is definiteness of appraisement, it applies equally in both cases, since it depends upon the rate of exchange. The real difference between the two types of action is, therefore, not one of principle, but rather one of the method involved in the formation of the exchange rate.

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If we were to invoke Section 303 against selected exporters, on the ground of the currency procedures used in connection with their trade operations, we may easily find ourselves in the strange position of penalizing a country for conferring the presumed benefits of currency depreciation upon only a portion of its exports to us and of withdrawing the penalty as soon as such benefits are extended to all of its exports.

The Treasury Department has not at any time considered countervailing action against devaluation or depreciation as legally mandatory under Section 303, nor has it ever been seriously criticized or challenged on this score. It has clearly applied Section 303 heretofore, with what appears to be full legal propriety, on the basis of a much narrower interpretation of the term "grant" than is now proposed.

In view of these considerations, the subcommittee ventures to suggest (1) that the distinction between currency depreciation and currency manipulation from the point of view of the application of Section 303, is one of method rather than of principle; (2) that an interpretation of the term "grant", which would exclude from the operation of Section 303 not only currency devaluation and depreciation, but also currency manipulation, would do no violence to either the letter or the spirit of that Section; and (3) that such an interpretation is not likely to subject the Treasury Department to any more serious or valid criticism or challenge than its present procedure of not invoking Section 303 against devaluation and depreciation of foreign currencies.

III. The Problem of Reported Exchange Rates

An important question arising in connection with the consideration of currency measures under review in this report is that of the exchange rates used by the Customs Bureau in determining the value of goods imported into the United States. The basic rules for the conversion of foreign currencies for this purpose are laid down in Section 522 of the Tariff Act of 1930, which reads as follows:

> (a) Value of Foreign Coin Proclaimed by Secretary of Treasury. -- Section 25 of the Act of August 27, 1894, entitled "An Act to reduce taxation, to provide revenue for the Government, and for other purposes", as amended, is reenacted without change as follows:
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> "Sec. 25. That the value of foreign coin as expressed in the money of account of the United States shall be that of the pure metal of such coin of standard value; and the values of the standard coins in circulation of the various nations of the world shall be estimated quarterly by the Director of the Mint and be proclaimed by the Secretary of the Treasury quarterly on the 1st day of January, April, July, and October in each year."
>
> (b) Proclaimed Value Basis of Conversion. --For the purpose of the assessment and collection of duties upon merchandise imported into the United States on or after the day of the enactment of this Act, wherever it is necessary to convert foreign currency into currency of the United States, such conversion, except as provided in subdivision (c), shall be made at the values proclaimed by the Secretary of the Treasury under the provisions of section 25 of such Act of August 27, 1894, as amended, for the quarter in which the merchandise was exported.
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> (c) Market Rate When No Proclamation. —If no such value has been proclaimed, or if the value so proclaimed varies by 5 per centum or more from a value measured by the buying rate in the New York market at noon on the day of exportation, conversion shall be made at a value measured by such buying rate. If the date of exportation falls upon a Sunday

Sunday or holiday, then the buying rate at noon on the last preceding business day shall be used. For the purposes of this subdivision such buying rate shall be the buying rate for cable transfers payable in the foreign currency so to be converted; and shall be determined by the Federal Reserve Bank of New York and certified daily to the Secretary of the Treasury, who shall make it public at such times and to such extent as he deems necessary. In ascertaining such buying rate such Federal reserve bank may in its discretion (1) take into consideration the last ascertainable transactions and quotations, whether direct or through exchange of other currencies, and (2) if there is no market buying rate for such cable transfers, calculate such rate from actual transactions and quotations in demand or time bills of exchange.

In actual practice, the Federal Reserve Bank of New York reports at the present time two types of exchange rates--"actual" and "nominal". According to the data furnished by the Bank, twenty-seven banks and bankers in New York City furnish daily their buying rates at noon for cable transfers to the principal countries of the world. An average of these rates is then certified to the Secretary of the Treasury. The general procedure as described by the Bank is as follows:

"If the banks and bankers in New York City are in a position to quote firm buying rates for a given currency, and if at noon of a particular day they stand ready to buy an appreciable amount of that currency (say about £10,000 etc.) that rate would be termed 'actual'. On the other hand, if no real market exists in a given currency, and the banks are unwilling to make firm bids for that currency so that a purchase or sale must become a matter of individual negotiation, the noon buying rate would be listed as 'nominal'. In general this is the basis upon which so-called actual and nominal buying rates are determined.

"In the case of those countries, whose governments have imposed rigid foreign exchange restrictions, the New York market for exchange of any kind is reduced to small proportions by the limitations placed upon the movements of currencies to and from the home country. The banks usually will not purchase appreciable amounts of these controlled currencies due to their own unwillingness to carry foreign

foreign balances in currencies which cannot be freely repatriated and due to the absence of other buyers to whom they might dispose of such foreign currencies if bought. Therefore the banks quote us nominal noon buying rates for these currencies, based on quotations received from abroad. This situation exists particularly with respect to Austria, Bulgaria, Hungary and Italy.

"Rigid foreign exchange regulations exist also in five South American countries, Argentina, Brazil, Chile, Uruguay and Colombia. In these cases, the buying rates that we receive from the New York banks are the official rates, established by the exchange authorities in the foreign countries, (at fixed ratios to either the U. S. dollar, the English pound, or the French franc) for the purpose of converting into their own currencies foreign exchange surrendered to them by exporters in their markets, pursuant to their various governmental decrees. These official rates are all designated as nominal since the New York exchange market does not deal in exchanges on these five South American countries at official rates, but transacts whatever business there is at so-called free rates which are considerably lower.

"The exchange rates for Australia, New Zealand and South Africa are also classified as 'nominal' by the New York banks and in our certifications of noon buying rates to the Treasury. The currencies of these three countries are linked to the pound sterling at fixed ratios and are maintained at the prescribed levels through exchange controls. Business in Australian, New Zealand, or South African pounds being very small in the New York market, the banks furnish us with noon buying rates on these currencies calculated on the basis of the sterling dollar exchange rate. These buying rates are termed nominal because the banks are not willing to make firm bids for appreciable amounts of Australian, New Zealand, or South African pounds at the rate thus calculated by them."

An examination of the exchange rates certified by the Federal Reserve Bank of New York discloses a situation which has an important bearing upon the problem under consideration. For example, the rate quoted for the Austrian schilling is 18.8416 cents, rather than the nominal parity of 23.82 cents. Similarly, the rate for the Rumanian leu is quoted at .7350 cents, as against the

the nominal parity of 1.01 cents. On the other hand, the Hungarian pengö is quoted at the nominal parity, in spite of the fact that, in effect, Hungary operates on the basis of very much the same system as do Austria and Rumania. The rate for Germany is also quoted at the gold parity and is certified as an actual rate. No rates at all are given for Latvia and a number of smaller countries.

The subcommittee recommends the advisability of a thorough examination of the problem involved in the determination and certification of foreign exchange rates. On the basis of such consideration as the subcommittee has been able to give to this problem, it would like to suggest (1) that in cases like that of Hungary the reporting by the Federal Reserve Bank of New York of the actual rate at which dollars are bought and sold would very likely remove any reason for even contemplating the imposition of countervailing duties on goods imported from such a country; and (2) that if its thesis that multiple currencies should properly be regarded as special cases of depreciation is valid, there would appear to be a material convenience in recognizing the existence of multiple currency systems through a reporting of the various exchange rates actually in use by a country operating on the basis of such a system. Without wishing to pass on the legal aspect of this problem, the subcommittee feels that paragraph (c) of Section 522, quoted above, would appear to provide a sufficient measure of flexibility to render possible the reporting of multiple exchange rates, at least in such important cases as that of Germany.

IV. Considerations of General Policy

An examination of the problems of the application of Section 303 in cases arising out of currency measures cannot be divorced from considerations of general economic policy. The subcommittee is of the opinion that the provisions for countervailing action embodied in our tariff legislation for the past three and one-half decades have been clearly intended to operate in more or less normal conditions in the sphere of monetary relations against practices designed to introduce disturbing influences into international trade relations. But the application of countervailing action in conditions of abnormally disturbed monetary relations against measures of monetary character is likely to make confusion worse confounded. Far from correcting the disturbances caused by the measures against which countervailing action would be invoked, such action is more likely to introduce new disturbing elements into an already disturbed situation.

The subcommittee does not wish to pass upon the desirability or undesirability from the general economic point of view of the application of Section 303 to cases which clearly and unmistakably fall within the scope of the bounty or grant concept. In such cases, the existing statutes obviously govern the action to be taken, irrespective of the economic considerations that might be involved. The subcommittee is, however, strongly of the opinion that in those cases in which the interpretation of the legal provisions is legitimately in doubt, economic considerations should be given definite weight in any decisions that might be reached.

Currency measures of the type dealt with in this report are partly the cause and partly the result of the monetary dislocation through which the world is passing at the present time. We, ourselves, have been the victim of monetary disturbances which originated elsewhere and have, in turn, contributed to an intensification of monetary dislocation. The subcommittee is of the opinion, therefore, that it will be most unfortunate if we attempted to take special measures against currency procedures in other countries. This consideration applies with equal force to currency devaluation, depreciation, and manipulation.

It is true that of the three types of currency measures,

manipulation

manipulation is, generally speaking, probably the most disturbing and the least desirable. But it happens to be the method chosen by some countries as a transitional procedure to, or as a temporary measure designed to avoid, an open depreciation or definitive devaluation of their currencies.

With these general considerations in mind, the subcommittee wishes to make the following observations on the three specific cases with respect to which countervailing action is now in contemplation:

1. In the case of Hungary, the Treasury Department is considering the question of imposing a countervailing duty on the importation of feathers on the ground that the exporters of feathers to the United States are enabled to secure a rate of exchange 50 percent above the official rate in the conversion of their dollar proceeds into the domestic currency. Since, however, all holders of dollars under existing exchange control regulations in Hungary are enabled to obtain the same rate of exchange, there would appear to be no reason for taking any specific action against the exporters of a single commodity, unless other procedures are involved.

2. The case of Latvia in which the Treasury Department is considering countervailing duty action on the ground of currency manipulation relating to butter exports, has a peculiar aspect in that, according to available information, butter is exported to this country from Latvia only by a government-controlled monopoly. From this point of view the Latvian case has many points of similarity to the case of the Soviet Union in which all exports are handled by a government monopoly and with respect to which it is difficult to see how any action can be taken under Section 303.

3. In the case of Germany, the Treasury contemplates the imposition of countervailing duties on a list of products in the marketing of which there appears to be no doubt that blocked marks, ASKI accounts, and bond and scrip procedures are employed in varying degrees. In an official statement handed to the American Embassy in Berlin on March 21, the German Government gave the following explanation of its action in this respect:

> The devaluation of the dollar and of the currencies of other important countries in international trade in conjunction with the adherence to the gold parity of the reichsmark currency have resulted in the dislocation of

the

> the purchasing power parities of the various currencies and consequently have necessarily also resulted in a dislocation of the level of prices of goods expressed in German currency as compared with the level of prices for the same goods expressed in American currency. The German measures only aim to adjust these dislocations at least in part and partially to remove the effects of the present abnormal international currency conditions. They are limited to this aim. They are not intended to influence the legal and natural economic factors which are decisive for competition.

In further explanation, the German Government states that at the present time payment for exports in blocked marks is permitted in varying degrees ranging from 25 to 95 percent of the total export value, presumably depending upon the competitive position of the various products in the foreign market. With respect to the use of the bond and scrip procedures, the German Government states:

> The selling price of the export goods is under no circumstances lower than the price at which the goods are generally offered in the open market in the United States. Price slashing and mutual underbidding in foreign markets are refrained from and suitable prices are achieved for German quality production. The export value declared in the consular invoice plus foreign exchange adjustment is in no case higher than the German domestic value.

The German Government, throughout its communication, emphasizes the fact that it has made a special effort to limit the possible disturbing effects of its currency manipulation upon the American market. It states specifically and categorically that it is refraining from extending to exporters to the United States the benefit of any of the devices for direct subsidization which are now in operation in Germany in addition to the currency procedures.

The subcommittee has no doubt as to the correctness of the claim made by the German Government that the sale of German products in the United States would be greatly hampered and, therefore, drastically reduced if Germany would attempt to market her goods in this country without the aid of the currency procedures now employed. The

same

same result would be achieved by a neutralization of the effects of these procedures through an imposition of countervailing duties. This, in turn, would lead to a drastic reduction of our sales to Germany.

There appears to be no doubt that Germany is experiencing at the present time genuine difficulties in procuring dollar exchange with which to pay for her imports from the United States. Her purchases from the United States, particularly of agricultural products and certain raw materials such as cotton, fruit, tobacco, lard, lumber, petroleum, and copper, have already been greatly reduced. Such trade as still exists has been made possible by the employment by the German Government of the special currency arrangements already described. The imposition of countervailing duties on a long list of German goods because of such arrangements would, of course, reduce our purchases of German goods and thus lead to a still further loss in our sales to Germany.

Moreover, at the present time we are endeavoring to induce the German Government to remove important discriminations against our trade which grow out of the operation of the German system of foreign exchange control. It is certain that inauguration of countervailing action against Germany at this time would create an extremely unfavorable psychological atmosphere, in which our chances of success in this difficult effort would definitely decrease. Such action would thus do injury to our economic interests far beyond even the serious direct harm to our export trade which would flow from a reduction of our imports from Germany.

The subcommittee feels, therefore, that so long as the action of the German Government in the promotion and facilitation of exports to the United States is limited to the currency procedures now employed, it would appear to be a part of economic wisdom for our Government to refrain, as a matter of policy, from invoking against Germany the machinery of countervailing action.

(Mr. Graves' reaction to first meeting with Canadian representatives.

In this conference the Canadian position in opposition to this legislation was again stated by Mr. Wrong. As to the attitude of the Canadian distillers, they are saying that on the question of at this time giving assurance to the Treasury that they will submit to the jurisdiction of our courts and put up a guaranty that they will pay any judgments which may be rendered in our courts, that that is a question which they cannot now talk about. They would have to refer that to their Boards of Directors and possibly even to their shareholders. A long time would probably ensue, it would probably take weeks or months of time.

Then the other important thing is all these people are taking the position that they cannot give assurances to this department until they know the amounts of our claims against them.

They have now confessed or conceded that they cannot now give us any assurance of the kind we had asked for, so we are bound to go on and try to get this legislation because if we wait until it is submitted to their boards of directors or shareholders, Congress will have adjourned.

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

MARCH 30, 1936

UNITED STATES
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REVENUE ACT, 1936

MONDAY, MARCH 30, 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 please come to order.

I suppose everyone knows the purpose of the meeting of the Committee on Ways and Means today. It is to give consideration to the tax bill to which the attention of Congress was called by the President's message.

It is also well known that a subcommittee of the Committee on Ways and Means has been giving study to this subject for a period of about 3 weeks, with a view to preparing a report as a basis of hearings by the full committee.

I offer for the record the message from the President of the United States and also the report of the Subcommittee of the Ways and Means Committee relative to proposed tax revision.

(The documents referred to are as follows:)

[H. Doc. No. 418, 74th Cong., 2d sess.]

MESSAGE FROM THE PRESIDENT OF THE UNITED STATES TRANSMITTING ADDITIONAL INFORMATION CONCERNING THE BUDGET FOR THE FISCAL YEAR 1937

To The Congress of the United States:

On January 3, 1936, in my annual Budget message to the Congress, I pointed out that without the item for relief the Budget was in balance. Since that time an important item of revenue has been eliminated through a decision of the Supreme Court, and an additional annual charge has been placed on the Treasury through the enactment of the Adjusted Compensation Payment Act.

I said in my Budget message:

"* * * the many legislative acts creating the machinery for recovery were all predicated on two interdependent beliefs. First, the measures would immediately cause a great increase in the annual expenditures of the Government—many of these expenditures, however, in the form of loans which would ultimately return to the Treasury. Second, as a result of the simultaneous attack on the many fronts I have indicated, the receipts of the Government would rise definitely and sharply during the following few years, while greatly increased expenditure for the purposes stated, coupled with rising values and the stopping of losses, would, over a period of years, diminish the need for work relief and thereby reduce Federal expenditures.

The increase in revenues would ultimately meet and pass the declining cost of relief.

"This policy adopted in the spring of 1933 has been confirmed in actual practice by the Treasury figures of 1934, of 1935, and by the estimates for the fiscal years of 1936 and 1937.

"There is today no doubt of the fundamental soundness of the policy of 1933. If we proceed along the path we have followed and with the results attained up to the present time we shall continue our successful progress during the coming years."

If we are to maintain this clearcut and sound policy, it is incumbent upon us to make good to the Federal Treasury both the loss of revenue caused by the Supreme Court decision and the increase in expenses caused by the Adjusted Compensation Payment Act. I emphasize that adherence to consistent policy calls for such action.

To be specific: The Supreme Court decision adversely affected the Budget in an amount of $1,017,000,000 during the fiscal year 1936 and the fiscal year 1937. This figure is arrived at as follows:

Deficit to date (expenditures chargeable to processing taxes less processing taxes collected) in excess of that contemplated in the 1937 Budget	$281,000,000
Estimated expenditures to be made from supplemental appropriation approved in the Supplemental Appropriation Act, 1936	296,000,000
Estimated expenditures to be made under the Soil Conservation and Domestic Allotment Act	440,000,000
Total additional deficit 1936 and 1937, due to Supreme Court decision and adjusted farm program	1,017,000,000

For the purposes of clarity, I divide the present total additional revenue needs of the Government into the permanent and the temporary ones.

Permanent Treasury income of $500,000,000 is required to offset expenditures which will be made annually as a result of the Soil Conservation and Domestic Allotment Act recently enacted by the Congress and approved by me; and an additional sum recurring annually for 9 years will be required to amortize the total cost of the Adjusted Compensation Payment Act.

The net effect of paying the veterans' bonus in 1936, instead of 1945, is to add an annual charge of $120,000,000 to the $160,000,000 already in the Budget.

We are called upon, therefore, to raise by some form of permanent taxation an annual amount of $620,000,000. It may be said, truthfully and correctly, that $500,000,000 of this amount represents substitute taxes in place of the old processing taxes, and that only $120,000,000 represents new taxes not hitherto levied.

I leave, of course, to the discretion of the Congress the formulation of the appropriate taxes for the needed permanent revenue. I invite your attention, however, to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop "leaks" in present surtaxes.

Extended study of methods of improving present taxes on income from business warrants the consideration of changes to provide a fairer distribution of the tax load among all the beneficial owners of

business profits whether derived from unincorporated enterprises or from incorporated businesses and whether distributed to the real owners as earned or withheld from them. The existing difference between corporate taxes and those imposed on owners of unincorporated businesses renders incorporation of small businesses difficult or impossible.

The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, 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 current surtaxes altogether.

This method of evading existing surtaxes constitutes a problem as old as the income tax law itself. Repeated attempts by the Congress to prevent this form of evasion has not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over 4½ billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand, it will be withheld from stockholders by those in control of these corporations. In 1 year alone, the Government will be deprived of revenues amounting to over $1,300,000,000.

A proper tax on corporate income (including dividends from other corporations), which is not distributed as earned, would correct the serious twofold inequality in our taxes on business profits if accompanied by a repeal of the present corporate income tax, the capital-stock tax, the related excess-profits tax, and the present exemption of dividends from the normal tax on individual incomes. The rate on undistributed corporate income should be graduated and so fixed as to yield approximately the same revenue as would be yielded if corporate profits were distributed and taxed in the hands of stockholders.

Such a revision of our corporate taxes would effect great simplification in tax procedure, in corporate accounting, and in the understanding of the whole subject by the citizens of the Nation. It would constitute distinct progress in tax reform.

The Treasury Department will be glad to submit its estimates to the Congress showing that this simplification and removal of inequalities can, without unfairness, be put into practice so as to yield the full amount of $620,000,000—the amount I have indicated above as being necessary.

Turning to the temporary revenue needs of the Government, there is the item of $517,000,000, which affects principally the current fiscal year. This amount must in some way be restored to the

Treasury, even though the process of restoration might be spread over 2 years or 3 years.

In this case also the formulation of taxes lies wholly in the discretion of Congress. I venture, however, to call your attention to two suggestions.

The first relates to the taxation of what may well be termed a windfall received by certain taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them or which otherwise have remained unpaid. In unequal position is that vast number of other taxpayers who did not resort to such court action and have paid their taxes to the Government. By far the greater part of the processing taxes was in the main either passed on to consumers or taken out of the price paid producers. The Congress recognized this fact last August and provided in section 21 (d) of the Agricultural Adjustment Act that, in the event of the invalidation of the processing taxes, only those processors who had borne the burden of these taxes should be permitted to receive refunds. The return of the impounded funds and failure to pay taxes that were passed on result in unjust enrichment, contrary to the spirit of that enactment. A tax on the beneficiaries unfairly enriched by the return or nonpayment of this Federal excise would take a major part of this windfall income for the benefit of the public. Much of this revenue would accrue to the Treasury during the fiscal years 1936 and 1937.

The other suggestion relates to a temporary tax to yield the portion of $517,000,000 not covered by the windfall tax. Such a tax could be spread over 2 years or 3 years. An excise on the processing of certain agricultural products is worth considering. By increasing the number of commodities so taxed, by greatly lowering the rates of the old processing tax, and by spreading the tax over 2 or 3 years, only a relatively light burden would be imposed on the producers, consumers, or processors.

FRANKLIN D. ROOSEVELT.

THE WHITE HOUSE, *March 3, 1936.*

[H. R. committee print, Mar. 26, 1936, 74th Cong., 2d sess.]

REVENUE BILL OF 1936—REPORT OF THE SUBCOMMITTEE OF THE COMMITTEE ON WAYS AND MEANS RELATIVE TO PROPOSED TAX REVISION

This report embodies the recommendations of the subcommittee of the Ways and Means Committee to the full committee with respect to the taxation of undistributed income of corporations, elimination of the present corporation tax, termination of the capital-stock tax and excess-profits tax, imposition of taxes on unjust enrichment occurring as a result of the nonpayment of excise taxes, and related matters.

The recommendations submitted herewith contemplate only such changes in the Revenue Act of 1934, as amended, as are necessary to carry out the policies herein set forth. In some cases, however, in order that there may be a clear understanding of the scope of the subcommittee's proposals, a specific statement has been made that no change in the present law is proposed with respect to the particular matter.

I

TAXABLE YEARS TO WHICH APPLICABLE

The changes proposed in the present income tax (Titles I and IA of the Revenue Act of 1934, as amended) will be applicable to taxable years (whether calendar or fiscal) beginning after December 31, 1935. That is, taxpayers on a calendar year basis will first report their income under, and be subject to tax as provided in the new proposals for, the calendar year 1936 and their returns for such year will be due on or before March 15, 1937. Taxpayers on a fiscal year basis whose fiscal years begin in 1936 will similarly report and pay tax for taxable years beginning in 1936 and ending in 1937, and the returns will be due on or before 2½ months after the end of such taxable years.

II

TAX ON UNDISTRIBUTED INCOME OF CORPORATIONS

It is recommended that there be substituted for the present graduated corporation tax a tax on the income of corporations graduated according to the percentage of their income which is undistributed, and that for the purposes of this tax corporations be divided into two classes on the basis of the amount of their net income. The recommendations specifically are as follows:

For the purpose of the schedules hereinafter recommended the term "adjusted net income" means the net income (see recommendation No. XV relating to intercorporate dividends) less the credit allowed by section 26 of the Revenue Act of 1934 (relating to interest on Liberty Bonds and interest on obligations of Government corporations).

The term "undistributed net income" means the adjusted net income minus the sum of:

(1) Taxable dividends paid during the period beginning on the expiration of 2½ months after the beginning of the taxable year and ending on the expiration of 2½ months after the close of the taxable year (see recommendations Nos. XI, XIII, XIV, and XVIII); and

(2) The tax computed under the schedules contained in this recommendation.

The schedules proposed are as follows:

SCHEDULE 1. CORPORATIONS WITH ADJUSTED NET INCOME OF $10,000 OR LESS

If there is no undistributed net income, there shall be no tax on the adjusted net income.

If the undistributed net income is 10% of the adjusted net income, the rate of tax on the adjusted net income shall be 1%.

If the undistributed net income is 20% of the adjusted net income, the rate of tax on the adjusted net income shall be 3½%.

If the undistributed net income is 30% of the adjusted net income, the rate of tax on the adjusted net income shall be 7½%.

If the undistributed net income is 40% of the adjusted net income, the rate of tax on the adjusted net income shall be 13%.

If the undistributed net income is 50% of the adjusted net income, the rate of tax on the adjusted net income shall be 18½%.

If the undistributed net income is 60% of the adjusted net income, the rate of tax on the adjusted net income shall be 24%.

If the undistributed net income is 70% of the adjusted net income, the rate of tax on the adjusted net income shall be 29½%.

If the undistributed net income is 70.3% of the adjusted net income, the rate of tax on the adjusted net income shall be 29.7%.

SCHEDULE II. CORPORATIONS WITH ADJUSTED NET INCOMES OF MORE THAN $10,000

If there is no undistributed net income, there shall be no tax on the adjusted net income.

If the undistributed net income is 10% of the adjusted net income, the rate of tax on the adjusted net income shall be 4%.

If the undistributed net income is 20% of the adjusted net income, the rate of tax on the adjusted net income shall be 9%.

If the undistributed net income is 30% of the adjusted net income, the rate of tax on the adjusted net income shall be 15%.

If the undistributed net income is 40% of the adjusted net income, the rate of tax on the adjusted net income shall be 25%.

If the undistributed net income is 50% of the adjusted net income, the rate of tax on the adjusted net income shall be 35%.

If the undistributed net income is 57½% of the adjusted net income, the rate of tax on the adjusted net income shall be 42½%.

If the percentage which the undistributed net income is of the adjusted net income is not one of the percentages of the adjusted net income shown in Schedule I or II, then the rate of tax shall be proportionate.

If the adjusted net income is more than $10,000 the tax, at the option of the corporation, shall, in lieu of being computed under Schedule II, be computed by adding:

(1) A tax upon the adjusted net income computed under Schedule I; and

(2) A tax upon the amount of the adjusted net income in excess of $10,000, at the rate in Schedule II which would be applied if the tax were being computed solely under such Schedule.

III

EXEMPTION OF BANKS

It is recommended that incorporated banks and trust companies bona fide operated as such be exempted from the plan proposed under recommendation No. II and be subject to a tax of 15% on the net income (see recommendation No. XV relating to intercorporate dividends) in lieu of the present graduated corporation tax. It is further recommended that banks continue to be subject to section 102 of the Revenue Act of 1934 relating to accumulation of surplus to avoid surtax.

The subcommittee leaves to the full committee as an unsettled question whether dividends paid by banks to shareholders, individual or corporate, should be treated under the present law or whether they should be fully taxable like dividends paid by other corporations.

IV

TREATMENT OF INSURANCE COMPANIES

It is recommended that all bona fide insurance companies (mutual and stock, foreign and domestic) be exempted from the plan proposed under recommendation No. II and be subject to a tax of 15% 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% in lieu of the graduated rates under existing law.

It is recommended that dividends received by all insurance companies be treated the same as dividends received by other corporations (see recommendation No. XV).

V

CORPORATIONS IN RECEIVERSHIP

It is recommended that corporations in receivership be exempt from the plan proposed under recommendation No. II and be subject to a tax of 15% in lieu of the graduated rates under existing law.

Dividends received by such corporations shall be included in net income, and dividends paid by them shall be subject to tax in the hands of the shareholder as in the case of dividends paid by other corporations.

VI

FOREIGN CORPORATIONS

It is recommended that foreign corporations be exempt from the plan proposed under recommendation No. II and be subject to a tax of 22½% instead of the rate under existing law, accompanied by a change in the rate on withholding under existing law to 22½%.

VII

RAILROADS

It is recommended that railroads be subject to the plan proposed under recommendation No. II and the privilege of filing consolidated returns be continued as to them; the rate of tax to be the same as in the case of other corporations under recommendation No. II; but with the right to make a new election whether or not to file a consolidated return for their first taxable year under the new law.

If in the affiliated group the parent corporation is in receivership the entire group shall be taxed as other corporations in receivership (see recommendation No. V). If any other member of the group is in receivership it does not gain the exemption referred to in recommendation No. V.

VIII

EXEMPT CORPORATIONS GENERALLY

It is recommended that corporations now exempt from income tax under section 101 of the Revenue Act of 1934 (labor, agricultural, charitable, and other nonprofit corporations), be exempt from the new plan and from the corporation tax under existing law.

IX

CAPITAL STOCK TAX

The rate of capital stock tax imposed by section 105 of the Revenue Act of 1935 is proposed to be reduced to 70 cents per $1000 of the adjusted declared value for the capital stock tax year ending June 30, 1936. This constitutes a substitution of a 70-cent rate for a $1.40 rate. The tax is proposed to be terminated for all later years.

X

EXCESS PROFITS TAX

The excess profits tax imposed by section 106 of the Revenue Act of 1935 is proposed to be terminated at the end of the first income tax taxable year of the taxpayer which ends after June 30, 1936. The rate is not changed. Corporations whose income tax taxable years are on a calendar year basis will be subject to this tax for the calendar year 1936. Corporations whose income tax taxable years are on a fiscal year basis, which years end after June 30, 1936, will be subject to that tax for the first income tax taxable year ending after such date. The tax will not apply to any income tax taxable year which ends after June 30, 1937.

XI

DIVIDEND CARRY-OVER

It is recommended that if the taxable dividends paid during the period beginning on the expiration of 2½ months after the beginning of the taxable year and ending on the expiration of 2½ months after the close of the taxable year are in excess of the adjusted net income for the taxable year, the excess (or if there is no adjusted net income, the entire amount of the taxable dividends) shall be allowable as a deduction in computing the undistributed net income for the succeeding taxable year, and, to the extent not needed to reduce the tax in such year (after first applying as a deduction any more recent dividend payments), then in the second succeeding taxable year.

XII

DIVIDENDS IN KIND

In computing undistributed net income, if a corporation declares a dividend in kind, the deduction will be computed at market or at the adjusted basis in the hands of the corporation, whichever is lower.

XIII

DIVIDENDS OUT OF PRE-MARCH 1, 1913, SURPLUS

It is recommended that dividends paid out of earnings and profits accrued before March 1, 1913, or out of increase in value accrued before March 1, 1913, be fully taxable when distributed.

XIV

NORMAL TAX ON DIVIDENDS

It is recommended that the present credit, allowed for normal tax purposes, of dividends received shall be abolished, so that all dividends will be subject to normal tax as well as to surtax.

XV

INTERCORPORATE DIVIDENDS

It is recommended that the present deduction allowed corporations for dividends received from other corporations be abolished, so that intercorporate dividends will remain in net income.

XVI

DIVIDENDS OUT OF PRE-1936 EARNINGS

It is recommended that dividends out of earnings and profits accumulated prior to the beginning of the first taxable year of the corporation under the new plan shall when declared out as dividends be fully taxable as in the case of the distribution of subsequent earnings and profits.

XVII

DIVIDENDS OUT OF EARNINGS TAXED UNDER NEW PLAN

It is recommended that no exemption from tax on the shareholder be given to dividends declared out of earnings and profits of a year in which the corporation has been subject to taxation under the new plan recommended under recommendation No. II.

XVIII

LIQUIDATING DIVIDENDS

In computing undistributed net income, it is recommended that the corporation be allowed a deduction for any part of liquidating dividends properly allocable to earnings and profits, but no deduction shall be given for the portion thereof properly chargeable to capital account.

XIX

NET INCOME IN EXCESS OF ACCUMULATED EARNINGS AND PROFITS

It is recommended that relief be provided for the corporation which, while having an adjusted net income for the taxable year, lacks sufficient accumulated earnings and profits as of the close of the taxable year from which to distribute taxable dividends equal to the adjusted net income. For example:

(1) A corporation may have an adjusted net income of $100,000, but a deficit, carried over from prior years, of $150,000. Any distribution by the corporation could not be out of accumulated earnings and profits, would not be taxable as a dividend to the shareholders, and hence, under the rule previously recommended (see definition of

"undistributed net income" in recommendation No. II), would not be deductible by the corporation from adjusted net income in computing undistributed net income. Therefore, even if an amount equal to the adjusted net income were distributed, the tax on the corporation would be the same as if no distribution were made.

(2) A similar hardship would exist where the net adjusted income is $100,000, with a prior deficit of $60,000. Here the maximum taxable dividend would be $40,000, and $60,000 would, even if distributed, be taxable to the corporation as if not distributed.

(3) Even if no deficit exists, hardship may exist where the earned surplus at the beginning of the taxable year is not enough to meet a nondeductible loss occurring during the year. Thus suppose the accumulated earnings and profits at the beginning of the year are $1,000, the adjusted net income $100,000, but a capital net loss of $40,000 has been sustained. The earnings and profits for the year are only $60,000, making the total accumulated earnings and profits $61,000. Therefore, without relief, the corporation must pay tax on $39,000 even if it distributes $100,000, an amount equal to the entire adjusted net income.

The relief recommended is as follows:

If the accumulated earnings and profits of the corporation as of the close of the taxable year (computed without diminution by reason of the distribution during the taxable year of earnings and profits) are less than the adjusted net income, the tax shall, in lieu of being computed under the schedules usually applicable, be computed by adding:

(a) a tax of 22½ per centum of the excess of the adjusted net income over the accumulated earnings and profits as of the close of the taxable year; and

(b) a tax upon the remainder of the adjusted net income in accordance with the schedule (see recommendation No. II) applicable to an adjusted net income equal to the amount of such remainder.

It should be provided that this provision shall in no case operate to increase the tax that would be payable without its application.

The effect of the recommended plan upon the examples above given is as follows:

Example No. 1: The tax would be 22½ per centum of the entire adjusted net income.

Example No. 2: The tax would be 22½ per centum of $60,000 plus the tax on $40,000 in accordance with the applicable schedule.

Example No. 3: The tax would be 22½ per centum of $39,000 plus the tax on $61,000 according to the applicable schedule.

XX

CONTRACTS NOT TO PAY DIVIDENDS

It is recommended 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 22½% on the part of the adjusted net income which equals the earnings and profits which it is prohibited by the contract from using for the payment of dividends, and on the remainder of the adjusted net income, if any, shall be taxed at the rates applicable under the appropriate schedule applicable to an adjusted net income equal to such remainder. It should be provided this provision shall in no case operate to increase the tax that would be payable without its application.

XXI

CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

Section 102 of the Revenue Act of 1934 is proposed to be made inapplicable except to banks, insurance companies exempt from the new graduated rate on undistributed net income, and foreign corporations.

XXII

PERSONAL HOLDING COMPANIES

Section 351 of the Revenue Act of 1934, as amended, is proposed to be made inapplicable to taxable years beginning after December 31, 1935.

XXIII

NON-RESIDENT ALIENS

It is recommended that no change be made in the normal tax and surtax of non-resident alien individuals but that the rate of withholding at the source under existing law be increased to 22½%; any overpayment of tax resulting therefrom to be refunded.

It is recommended that the Commissioner of Internal Revenue be given authority by regulations to exempt from withholding salaries and wages of non-resident alien individuals who go back and forth at frequent intervals.

XXIV

WINDFALL TAX

It is recommended that a tax at the rate of 90 per cent be imposed on unjust enrichment accruing to any person from shifting to others the burden of Federal excise taxes. This tax would apply to two classes of persons—

(1) Those who were supposedly liable for the tax and shifted its burden to others, but who did not pay the tax or who paid it and obtained a refund, and

(2) 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.

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.

In the second class, the tax would be computed as follows: The net income of the taxpayer arising from reimbursement to him by his vendors for excise tax burdens borne by him in the purchase of the

articles would be computed. The extent to which he had passed the tax on to his customers would then be determined. The tax would apply to the part of the net reimbursement which represents the amount of tax burden passed on to the customers.

The term "Federal excise tax" should be defined for such purposes to include all Federal internal revenue taxes with respect to articles and commodites, whether valid or invalid.

The proposed tax should apply retroactively to all income tax taxable years ending during the calendar year 1935 and to all subsequent taxable years. It will thus cover the cases of unjust enrichment arising as a result of the recent impounding and non-payment of processing taxes.

The net income in the categories specified above must be determined by the allocation of the proper deductions from the gross income arising in those categories, under rules and regulations in accordance with a general standard laid down by the bill.

It is suggested that a prima-facie rule be established for determining the extent to which the taxpayer shifted the excise tax burden to others. This can be accomplished by the comparison of the gross profit margin of the taxpayer with respect to the articles in question against the average gross profit margin of the taxpayer with respect to such articles during a representative period of two years preceding the initial imposition of the Federal excise tax. The gross profit margin would be the difference between the selling price of the articles and the cost of the raw materials entering into those articles, exclusive of indirect and overhead costs. 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 exceeded his gross profit margin during the representative period preceding the tax. 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. Allowance might also be made for lawyers' fees and expenses of litigation incurred in obtaining refund or preventing collection of the tax, or (in the case of the middleman) in obtaining reimbursement from the vendor for the tax burden. It is suggested, however, that the allowance of these fees and expenses be limited to 15 percent of the amount involved in the litigation.

Provision must also be made for the establishment of true costs and selling prices where the taxpayer has dealt through an affiliated corporation.

The above rules for determining the extent to which the tax burden was shifted should, of course, merely establish a presumption. 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. The bill should also provide for the consideration of proof that the taxpayer modified his contracts of sale to reflect the initiation, termination, or change in amount of the excise tax, or at such times changed his sale price, by substantially the amount of the tax or the change therein, or at any time billed the tax as a separate item to any vendee, or at any time indicated by any writing that his sale price included the amount of the tax, but should provide that the taxpayer may establish that such acts are not properly to be considered in connection with the particular sales in question.

Provision should be made against double taxation of the income subject to the proposed tax by the exclusion of the amount of income upon which the proposed tax is based from the computation of any other income tax on the taxpayer. Special provision will have to be made for returns in the case of taxable years which ended prior to the enactment of the bill.

XXV

FLOOR STOCKS TAX

The subcommittee recommends that appropriate provisions be enacted which will place all holders of floor stocks except the first domestic processor of articles processed from commodities subject to the processing tax on January 6, 1936, in substantially the same position they would have occupied had the processing taxes been terminated by proclamation by the Secretary of Agriculture in the manner provided by the Agricultural Adjustment Act.

The Agricultural Adjustment Act provided for a floor stocks tax on the effective date of the processing tax so that all articles, the product of the commodity subject to the processing tax, would move into channels of trade equally taxed. That act likewise provided for a refund upon termination of the tax to holders of floor stocks with certain limitations so that, in the main, articles on hand on that date and articles subsequently processed would also move into channels of trade, this time equally untaxed. Certain inequities have resulted from termination of that tax which require special treatment. The Committee feels that this result can be accomplished by appropriate legislation providing for refunds to holders of floor stocks on January 6, 1936, without proof of payment of the processing tax by the processor to the government. If the tax was not actually paid, any resultant advantage to the processor will be taken care of by the windfall income tax which is being recommended. The subcommittee feels, however, that this refund should be limited in amount to the amount by which the price of the finished article was reduced after the effective time of this floor stocks refund provision. Since the suggested remedial provision is not one required by law but is for the purpose of fair dealing, it is believed that the Commissioner's determination should be final and not subject to administrative or judicial review. In addition, because of the cost of handling such claims, both to claimants and to the government, we believe that a minimum limitation of $10.00 should be placed upon such claims. A similar provision was contained in the floor stocks provision of the Agricultural Adjustment Act.

The CHAIRMAN. The first witness today is Hon. Guy T. Helvering, Commissioner of Internal Revenue.

Mr. Helvering, will you please state for the record your name and the capacity in which you appear?

88340—36——2

STATEMENT OF HON. GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, TREASURY DEPARTMENT

Mr. HELVERING. Mr. Chairman and gentlemen, my name is Guy T. Helvering, Commissioner of Internal Revenue, appearing for the Treasury Department.

Mr. TREADWAY. Mr. Chairman, before Mr. Helvering starts his testimony, I would like to inquire whether a calendar has been made up for public hearings, and to what extent it has been made up.

I notice that the sheet that we have before us contains the names of Mr. Helvering and Mr. McLeod, both officials of the Treasury Department.

What is the intention of the chairman, if I may inquire, as to the procedure during the coming week?

The CHAIRMAN. Of course, that would be fixed largely by the committee. There has been no arrangement agreed upon or definitely decided upon, after those representing the Treasury Department have completed their testimony which we thought probably would take the day. The calendar has not been arranged definitely beyond that.

As soon as those gentlemen are finished, we thought it ould be advisable and proper to hear those who oppose the report that has been submitted and who want to be heard. The chairman has invited nobody. Those who desire to be heard on any provision of the report may confer with the chairman to learn what the wish of the committee is as to their appearance.

The desire of the committee is that adequate hearings be had and opportunity be given those who wish to appear in favor of or to oppose any recommendation that is made in the report.

Of course, it probably will not be possible to hear every person who may wish to be heard, but if those who want to be heard in opposition to or in favor of any provision of the report, will get together and select a person or persons to present their views and endeavor to agree on a reasonable time in which to present their views, the committee will extend them every courtesy.

We want to expedite the hearings of the committee as much as possible, and at the same time give a reasonable time to those who desire to appear and testify with respect to this matter which the committee has under consideration.

Mr. TREADWAY. Now may I ask whether it is the intention of the chairman to have a daily calendar, made up in advance, as has been done formerly, and have time assigned witnesses for the particular day?

I have had, as perhaps every member of the committee has had, numerous requests from people who want to be heard. Of course it is very awkward to be told that one may be here Monday morning and stay until called upon.

Formerly we had a calendar arranged several days in advance. Of course, I realize that we cannot hold to that strictly. But it does give people who come to Washington from a distance an opportunity at least tentatively to make plans.

Is it the intention of the chairman to continue that method of procedure?

The CHAIRMAN. The chairman knows what has been the usual procedure of the committee. So far as I know, there will be no deviation or departure from the regular course. We will follow that line as much as we possibly can.

The gentleman well knows that it is not possible to fix definite time for anyone on a particular day. The time can be fixed, but we cannot always hold to it.

Mr. TREADWAY. I realize that.

The CHAIRMAN. Sometimes we may have a half dozen witnesses scheduled to appear. Perhaps only half of them will finish their testimony. If a man has been set down to be heard on Tuesday, for instance, and has not been heard when that time arrives, he may have business that he may have to rush back to, and he may leave thinking he has not been treated well. We intend to arrange our calendar and our program for the accommodation of witnesses. We will do the very best we can.

Mr. TREADWAY. Then it is intended that a calendar shall be issued?

The CHAIRMAN. As far ahead as we can fix it.

Mr. TREADWAY. May I ask just one other question? Are we to be favored with the presence of the Secretary of the Treasury?

The CHAIRMAN. The Secretary—while I cannot speak for him—I have been informed, and reliably informed, that he has been indisposed for the past 3 or 4 weeks. I have talked with him several times over the telephone when he was confined to his room. Before he left the city, he told me he would be glad to come down and testify, if he were able to do so, and, if not, he would designate someone else to appear.

My information is that he has been out of the city. Has he returned, Mr. Helvering?

Mr. HELVERING. No, he has not returned.

The CHAIRMAN. I do not suppose that anyone would expect an ill man——

Mr. TREADWAY. I am only asking for information.

The CHAIRMAN. I am giving you the information that I have.

Mr. TREADWAY. In view of the statement of the chairman, I assume that that means that Mr. Helvering represents the Secretary of the Treasury. If not, are we to be favored with the presence of Mr. Oliphant, the Assistant Secretary?

The CHAIRMAN. I suggest that that question be directed to the Commissioner, Mr. Helvering, when he takes the stand.

Mr. TREADWAY. I am only trying to get this advance information, Mr. Chairman, in view of the fact——

The CHAIRMAN. Well, I cannot give it to you. I suggest that you direct your question to Mr. Helvering, when he starts to make his statement. That is all the chairman can do. I cannot speak for Mr. Helvering and I am not going to try to. He can speak for himself.

Mr. TREADWAY. Am I at liberty to ask Mr. Helvering that question?

The CHAIRMAN. I have just said that you could ask him the question when he testified.

Mr. COOPER. Mr. Chairman, I understand from the chairman's statement that this hearing is to be conducted along the same lines as all other hearings by this committee.

The CHAIRMAN. It will be, unless the committee directs otherwise.

Mr. COOPER. It was understood at the committee meeting last held that Mr. Helvering would be the witness appearing today, repre-

senting the Treasury Department and the administration. Therefore, Mr. Chairman, I move that we proceed to hear Mr. Helvering.

Mr. TREADWAY. I agree to the gentleman's motion.

The CHAIRMAN. Without objection, we will get down to the business for which the committee was called together this morning.

Mr. Helvering, you may proceed.

Mr. TREADWAY. Mr. Chairman, you said that I could ask a question.

The CHAIRMAN. You may.

Mr. TREADWAY. I thought the way Mr. Cooper was making his motion, that he was trying to cut me off.

The CHAIRMAN. The Chair does not think so.

Mr. TREADWAY. Have I permission to ask Mr. Helvering the question?

The CHAIRMAN. Certainly.

Mr. TREADWAY. Mr. Helvering, would you be kind enough to give us what information you can as to who will officially represent the Treasury Department at these hearings, other than yourself?

Mr. HELVERING. I just made the statement to the reporter, when I gave my name, that I was here representing the Treasury Department.

Mr. TREADWAY. And that goes for the whole hearing. We are not expected to hear Mr. Morgenthau, I realize, because he is ill. Will Mr. Oliphant appear and testify?

Mr. HELVERING. He will be here, but not this morning.

Mr. TREADWAY. He is to testify during the time that the Treasury Department will present their statement?

Mr. HELVERING. I do not know whether he is going to testify.

Mr. TREADWAY. He will honor us with his presence, then?

Mr. HELVERING. Yes; I think so.

Mr. TREADWAY. Thank you.

Mr. HILL. Mr. Chairman, I would like to ask Mr. Treadway just what his idea is in asking these questions as to who is representing the Treasury Department.

I want to make this statement, that the chairman of this committee has never given out a statement that anybody is going to be denied a reasonable opportunity to be heard at these hearings. The impression has been sought to be created by the gentleman from Massachusetts (Mr. Treadway) that we are going to try to cut witnesses off who are entitled to be heard and deny them reasonable time to be heard. There has been no such intimation from the chairman of this committee. That impression has been sought to be created simply for the purpose of prejudicing the country against the proceedings here in this committee.

Mr. VINSON. Mr. Chairman, regular order.

Mr. COOPER. Mr. Chairman, I insist on the regular order on my motion, already adopted.

Mr. TREADWAY. Mr. Chairman, I do not intend to take any scolding from Mr. Hill or the leader of the majority. I have my rights here, and I am going to exercise them.

The CHAIRMAN. I hope the gentleman is not insinuating that the chairman is trying to scold him.

Mr. TREADWAY. No; but your assistant did.

The CHAIRMAN. He has a right to make an observation.

Mr. TREADWAY. So have I, and I intend to do it, whether he likes it or not.

Mr. BOEHNE. Mr. Chairman, that being so, let us proceed with hearings on this tax bill.

Mr. HELVERING. Mr. Chairman, I would like to ask the privilege of proceeding with this statement to its conclusion. I have had prepared, and there has been furnished to the committee, a copy of this statement on which, if you desire, you can make any notations as I go along, or indicate the places where discussions might be had on the particular subject to which I have referred.

The CHAIRMAN. In other words, you wish to make your main statement without interruption and then you will yield for questions?

Mr. HELVERING. Yes.

The CHAIRMAN. That is our usual rule and custom, and without objection we will proceed with that understanding.

Mr. HELVERING. May I make the further request, Mr. Chairman, that at the conclusion of my statement and such questions as you may wish to ask me, we supplement that statement with an explanation of a chart, by Mr. McLeod, a statistician of the Treasury, who will explain in detail the statement which I have affixed to and which is the last page of the mimeographed statements that you have before you.

The CHAIRMAN. The Chair feels free to assure the witness that there will be no objection to that course.

Mr. HELVERING. Mr. Chairman, and gentlemen of the committee, I desire to make this statement in behalf of this report——

Mr. REED. Mr. Chairman, I do not want to interrupt the proceedings, but one of our colleagues is here and wishes to submit a statement of the dairy interests for the record. To save his time, may he hand that to the reporter at this time?

The CHAIRMAN. We do not know whether the statement is within the scope of the hearings.

Mr. REED. It relates to the question of taxation, does it not?

The CHAIRMAN. We do not know whether it relates to the matters contained in the committee report. We cannot open up the hearings and our record for any observations that anyone may want to make on the whole subject of taxation.

Mr. SAUTHOFF. May I suggest that this is merely a request to file this statement——

The CHAIRMAN. Would the gentleman mind withholding that for a little while? I assure the gentleman that he will be extended every courtesy.

Mr. SAUTHOFF. Thank you, Mr. Chairman.

The CHAIRMAN. Proceed, Mr. Helvering.

Mr. HELVERING. In his supplemental Budget message of March 3, the President outlined the following additional revenue requirements: First, 500 millions annually to take the place of the old processing taxes; second, 120 millions annually for the next 9 years to amortize the costs of the new bonus legislation of 1936; and third, some 517 millions, spread over the next several years, to compensate the Treasury for that part of the actual and anticipated deficits of the fiscal years 1936 and 1937 caused by the noncollection and refunding of the impounded portions of the processing taxes. In general, then, we need some 620 millions of additional regular annual revenues and about 517 millions of temporary revenues, the latter to be spread over the next 2 or 3 years.

Various alternative means of obtaining these revenues have received the careful study and consideration of the President, the Treasury officials, and members of this committee. The fact that some 61 percent of the total Federal revenues during the fiscal year 1935 was obtained from consumption and similar taxes has weighed heavily with all who have studied the problem against the recommendation of any additional excise taxes to provide the additional permanent revenues required. Further, it was felt that no increases in existing income-tax rates should be considered unless and until we were quite sure that all important sources of tax evasion or of tax avoidance in the existing income-tax laws had been eliminated. The President, in his supplemental Budget message, called attention to one outstanding source of inequality and of tax avoidance in the existing laws, the correction of which would provide the great bulk of the additional revenue requirements. After careful study, your subcommittee has reported to the full committee the outlines of a measure incorporating the substance of the President's suggestion, as well as concrete means for raising much of the temporary additions to our revenues that are needed.

I have had the privilege of attending many of the meetings of your subcommittee in the last few weeks, and other officers of the Treasury Department have been in attendance as their presence was desired to give the committee their technical assistance and their point of view. We have found ourselves from the outset to be in complete harmony of purpose with those of the committee who have taken the responsibility for constructing an outline of the basis on which the new revenue legislation should be drafted. I shall not attempt in any sense to speak on behalf of the subcommittee or to interpret their report to you, because it is not within the sphere of my authority to do so, and because the members of the subcommittee are much better able to perform that service than I am. I should be wasting my time and yours, however, if I did not regard the present status of the proposed legislation in discussing its principles and the benefits which we conceive will arise from it. In discussing these principles and these benefits and applying them to particular instances, I propose therefore to make use of the subcommittee's suggestions.

I think I owe it to this committee also to make a general statement about the subcommittee's report. The subcommittee has adopted and has incorporated into its report the principal suggestions made by the President in his tax message to the Congress of March 3. With these suggestions and the general purport of the committee's report, I am in complete accord. Your committee will naturally wish to give the very closest attention and consideration to your subcommittee's report, which represents 3 weeks of the most concentrated effort by a group of men with a comprehensive knowledge of and thorough grasp of tax problems. This committee will, I think, wish to consider the subcommittee's report in the light of two controlling considerations. These are:

(1) Are the proposals adequate to meet the needs for additional revenue in the light of the Budget position as set forth in the President's message?

(2) Do the proposals advance the principle of equity in our tax system?

As to the second question, my answer is unhesitatingly in the affirmative. Equity in our tax system will be greatly promoted by the enactment of tax legislation conforming with the plan outlined by the subcommittee. This applies both to the recommendation for temporary revenue and the recommendation for permanent additional revenue.

As to the first question, it must be said that so far as we have been able to make the calculations based upon the proposals of the subcommittee, it appears that they will not fully cover the needs for additional revenue set forth in the President's message. The schedules of rates proposed by the subcommittee for the corporation income tax, taken in conjunction with the recommended special treatment for certain classes of corporations, would produce additional revenues estimated at 591 millions, as compared with the figure of 620 millions that the President indicated was needed. More important, however, is the fact that the subcommittee has not made complete provision for the additional temporary revenues that will be required. It seems to me that your committee should consider whether there are not additional sources of temporary revenue that can be provided for the next 2 or 3 years to bridge this gap and to bring the measure that is to be enacted into full consistency with the President's recommendations for redressing the budget estimates.

I do not believe it necessary at this time to discuss in any detail the subcommittee's recommendation that the temporary increases in our revenues be raised in part by the imposition of a tax on the windfall and wholly unearned and unanticipated profits enjoyed by some processors and dealers who collected from the public taxes which they did not pay into the Federal Treasury. The reasonableness of such a measure, if carefully drafted and made perfectly fair, is in my opinion beyond question. The retention of the capital stock tax for the fiscal year 1936 at one-half the rate now incorporated in the law, as recommended by the subcommittee, will also meet some 80 millions of the temporary revenue requirements outlined by the President.

It is the permanent part of the tax program, however, to which I feel that I should give the greater part of my attention at this time. The primary purposes of the proposal to substitute for our present corporation income, capital stock, and excess profits taxes a corporation income tax based upon the proportion of corporate earnings retained by the corporation are, first, to eliminate the present inequalities in our taxation of business profits as between incorporated and unincorporated business; second, to remove a very important source of tax avoidance that inheres in our present income-tax laws; and third, as a consequence of the elimination of inequalities and sources of tax avoidance, to increase the Federal revenues to the extent necessary to balance the regular Budget of the Federal Government—that is, to balance all Federal expenditures other than those made for the purpose of relief.

The House subcommittee, in accordance with the substance of the President's recommendation, proposes to accomplish these purposes by repealing the existing corporation income, excess profits and capital stock taxes and substituting therefor a graduated tax schedule on corporation incomes, the graduation being based first on the size of the corporation income and second, and more fundamentally, upon the

proportion of a corporation's net earnings that are retained in its business.

When distributed to stockholders, corporation earnings become a part of the incomes of the individual stockholders and are subject to the graduated surtaxes. Corporate earnings which are not currently distributed in dividends now escape these surtaxes for long periods or altogether, thereby creating an unfair discrimination. All the earnings of a partnership or of an enterprise owned by a single individual, whether reinvested or not, are now subject to our income surtaxes.

If, for example, a partnership composed of four equal partners earned $1,000,000, the Federal Government would receive $517,136 of those earnings in individual income taxes, assuming that the partners were single men and had no other taxable income. If these same men conducted their business as a corporation and paid themselves salaries of $25,000 each but no dividends, the Federal Government would receive only $145,656 in income taxes—a difference of $371,480. Even if this corporation distributed 50 percent of its earnings, after the payment of $100,000 in salaries, in dividends, the Federal Government would still receive $174,400 less in taxes than it would receive if the business were conducted as a partnership.

The earnings withheld by corporations add no less to the wealth of the shareholders than the earnings distributed in dividends; for the reinvestment of corporate earnings becomes reflected in the stockholder's share of the net worth of the corporation and in increased earning power. It is worthy of note that the process of reinvestment of earnings frequently results in very large capital gains that escape capital gains taxes. The accrued capital gains of a lifetime, if obtained through the retention and automatic reinvestment of corporate earnings, escape all capital gains taxation because the law does not provide any tax on the increment between cost and market value at the time of death; the entire estate being subject only to the ordinary estate taxes, on the market value, that are paid by all estates. Thus, no special compensation is received by the Federal Government for the loss in revenues suffered during the lifetime of the owner by reason of his use of the corporate form.

Shareholders in corporations that pursue liberal dividend policies are now discriminated against because they are not permitted to reinvest tax-free the corporate earnings that they receive as dividends; whereas the stockholders in corporations that retain the bulk of their earnings are permitted under the present law to reinvest their share of the corporate earnings, in effect, without payment of individual income taxes thereon.

Further, the present ability of corporations and of their controlling stockholders to choose the timing of dividend distributions, without any effect upon the corporation's tax liability and without reference to current earnings, often results in a loss of revenue to the Federal Government and an unjust avoidance of taxation by stockholders of large personal incomes. The earnings withheld by a corporation would often, if distributed, raise the surtax brackets of stockholders, thereby putting the stockholders in the surtax brackets where they really belong. When withheld for a time, and then paid out in years when the other income of important stockholders is smaller, such earnings escape the higher rates to which they would have been subject. Individual businessmen and partnerships possess no corresponding choice for the timing of the distribution of earnings for income-tax purposes.

The present law also discriminates against stockholders with small incomes. The corporation earnings are subject to the 12½ to 15 percent corporation income tax, as well as to capital stock and excess profit taxes. As against these rates of 12½ to 15 percent taken out of earnings, plus the capital stock and excess profits taxes, amounting on the average to about an additional percent, the stockholders' dividend receipts are exempted only from the 4-percent normal tax. Under the President's proposal, it would be possible for a corporation to avoid income taxes altogether, and the small stockholder would pay only the normal tax of 4 percent on his dividends or no tax at all, according to his total income, instead of paying the present corporation income, capital stock, and excess profits taxes.

A further discrimination in favor of incorporated as contrasted with unincorporated business in the present law is to be found in the fact that an individual who reinvests in his business the large profits of 1 year, and subsequently experiences losses, is nevertheless subject in full to the income tax on the profits of his good year; whereas the stockholders of a corporation that similarly reinvest the large earnings of 1 year, and subsequently suffer losses, escape individual income taxes on the profits of the good years which have been wiped out.

On the other hand, the present law sometimes favors the partnership as against the small corporation. There are many corporations whose earnings, if wholly distributed among the shareholders, would not be subject to individual income taxes averaging from 12½ to 15 percent, because the shareholders of those corporations do not fall into sufficiently high surtax brackets. The corporate form of business organization is, nevertheless, desired by numerous small- and medium-sized enterprises for reasons of convenience, flexibility, and the like. Discrimination in taxation against the corporate form of business enterprise, as well as discrimination in its favor, would be removed by the present proposal.

In substance, a major result of the proposed measure would be to place all business, whether incorporated or not, on substantially the same basis for income-tax purposes.

The additional revenues that would be obtained by the Federal Government from the adoption of the President's proposal in substitution for the present corporation income, capital stock, and excess-profits taxes will result primarily from the removal of the kinds of inequality, discrimination, and tax avoidance that I have just outlined. These additional revenues will come mainly from members of the upper-income groups of our population. Our studies indicate that if corporations were to distribute to their shareholders all of their 1936 earnings, the taxable income of individuals would be increased by approximately four billion dollars. Of this large sum, more than 71 percent would be received by individuals with net incomes of more than $25,000 a year, and about 45 percent by individuals with net incomes in excess of $100,000 a year—individuals, in other words, who are subject to the higher surtax rates in our income-tax schedule. To the extent that corporations do not disburse their current earnings, after reasonable allowance for necessary reserves, the additional revenues will be obtained from higher corporation income taxes, roughly corresponding on the average to the rates that would have

been paid by their shareholders if corporate earnings were fully distributed. I am including in this statement an estimated distribution of individual income as prepared by the Treasury Department.

In my opinion, the President's proposal can be incorporated in such form as to make ample provision for the practical requirements of corporate business. There is no intention or desire whatever to interfere with the internal management of business enterprises. The object of the proposed revenue measure is not to tell corporate management what proportion of earnings they shall distribute and what proportion they shall retain. The object is, rather, to see that, whatever the decisions of corporate managements, the Federal Government shall not be unreasonably and inequitably deprived of necessary revenues. Likewise, it is not the policy of the Administration to dictate whether business shall be carried on as individual enterprises or partnerships on the one hand, or as corporations on the other hand. The present laws go a long way toward doing so by making the use of the corporate form unduly expensive for the little fellow and by offering a source of tax avoidance for the big fellow. It is proposed to remove this inequality.

There has been considerable discussion about the necessity for the accumulation of corporate reserves and surpluses; and a great deal of misapprehension has arisen respecting the effects of the subcommittee's proposal in this connection. Several things ought to be made emphatically clear:

First. The proposal involves no new corporate taxation whatever with respect to existing surpluses.

Second. The proposal does not at all affect the liberal provisions of present laws for the deduction of ordinary operating reserves, such as those for depreciation, depletion, obsolescence, bad debts, and the like, from taxable income. All such reserve allowances will be deductible as at present from the taxable incomes of corporations.

Many people do not realize how important these deductible reserves are. Between 1926 and 1929, inclusive, the aggregate deductions from taxable income for depreciation and depletion reported by all corporations amounted to 16.2 billions. During the succeeding 4 years, 1930–33 inclusive, the deductions for depreciation and depletion reported by all corporations aggregated 16.4 billions. Taking the aggregate figures only for corporations reporting net incomes during these two 4-year periods, we find that between 1926 and 1929, inclusive, the aggregate deductions from taxable net income for depreciation and depletion amounted to a sum equal to 31.2 percent of the aggregate statutory net income reported. For the years 1930–33, inclusive, such deductions amounted to a sum equal to 49.9 percent of the aggregate statutory net income reported. In other words, the liberal provisions of the law with respect to deductions for depreciation and depletion—provisions which would be retained under the new plan—already permit very substantial operating reserves free from taxation.

Third, taking as an example the rate schedules proposed by the subcommittee, it would be possible for any corporation to retain in its surplus a substantial proportion of its current earnings, over and above the reserves previously mentioned, without paying as much in taxes as it pays under the present law. The subcommittee has proposed one rate schedule for corporations with adjusted net incomes of

$10,000 or less, and another rate schedule for corporations with adjusted net incomes of more than $10,000. Under the first schedule, a corporation would pay a tax of only 7½ percent of its adjusted net income if it retained for surplus 30 percent of its adjusted net income; its tax rate would be only 13 percent if it retained for surplus an amount equal to 40 percent of its adjusted net income. At the present time, such a corporation would pay more than 13 percent in corporation income, capital stock, and excess profits taxes, regardless of its distribution of earnings. Corporations with adjusted net incomes of $10,000 or less, whose taxes would be substantially reduced under this measure, comprise more than 80 percent in number of all corporations.

Large corporations could carry 30 percent of their current earnings to surplus without paying as much in corporate taxes as they pay under the present law. The tax rate would be 15 percent for such corporations under the schedule recommended by the subcommittee. The present average tax rate on corporation incomes, including the capital stock and excess-profits taxes, approximates 15.5 percent.

Corporations that directly retain from current earnings more than 40 percent in the case of smaller corporations and more than 30 percent in the case of larger corporations would pay higher taxes under the subcommittee's proposal than they pay under the present law. These higher rates for corporations withholding a very large proportion of their current earnings are necessary both in the interest of fairness and to compensate the Federal Government for the loss in surtax revenues that results from such retention.

For corporations with adjusted net incomes between $10,000 and $20,000, as well as, under certain conditions, for corporations with adjusted net incomes ranging up to $40,000, the schedules recommended by the subcommittee provide effective rates of tax intermediate between those applicable to corporations with adjusted net incomes in excess of $10,000 and those applicable to corporations with adjusted net incomes of $10,000 or less.

In accordance with its desire to frame the outlines of a measure that would take full account of practical requirements, the subcommittee has recommended special treatment for certain classes of corporations. It may well be that your committee will find it desirable to include certain special provisions of this character in the final draft of its bill. I should like to emphasize, however, that virtually every case of special treatment involves a loss of revenue; and I should like to emphasize further that every case of exemption tends to impair the general symmetry and equity of the proposed measure. While, therefore, your committee may well find that certain exemptions are justifiable, it is highly desirable that they be kept at a minimum consistent with fairness and sound public policy.

It is my opinion that the reform of corporation income taxation now proposed may well be considered in the light of the history of income taxation in the United States. The principles incorporated in the present proposals are not new. In fact, they received the attention of the Congress in the very earliest period of Federal income taxation, the years 1862–71, when Congress provided that the gains and profits of corporations should be included in the annual gains, profit or income of any person entitled to the same, whether divided or otherwise. Shortly before and while the Revenue Act of 1921

was under consideration, a proposal identical in principle with that incorporated in the subcommittee's report received the widespread attention of representatives of organized business, Members of Congress, and the Treasury staff. In a somewhat modified form, it was incorporated in a bill passed by the Senate in 1924. So eminent a taxation authority as the late Prof. T. S. Adams, of Yale University, former chairman of the Advisory Tax Board in the Bureau of Internal Revenue, and for many years a Treasury advisor, went on record in 1918 and subsequently in favor of the taxation of undivided profits at the rates that would apply if such profits were distributed to the shareholders. "Fiscal necessity—and personally, I believe, logic as well—", declared Professor Adams, "requires the taxation of all profits, whether reinvested or not." A similar recommendation was made by Secretary of the Treasury Houston in his Annual Report for the year 1920.

When the repeal of the excess-profits tax was being considered, there were many who advocated the principles incorporated in the President's proposal as a substitute therefor. And in many respects the tax plan now proposed would achieve the essential objectives of an excess-profits tax without the great administrative difficulties that have been experienced in connection with an excess-profits tax proper. Corporations that earn unusually large profits would either pay out a very large fraction of them and thereby subject these unusual profits to the graduated surtaxes applicable to individual incomes, or, if they retained them, such profits would be subject to the higher rates of tax incorporated in the subcommittee's schedules.

The revenue-producing alternatives that might be offered in lieu of the proposed taxation of corporate incomes on the basis of withheld earnings appear to be distinctly inferior to the subcommittee's proposal as respects equity or administrative feasibility. To raise an equal sum of additional revenues through an increase in the present corporation income tax, it has been estimated that a rate approximating 25½ percent would be necessary. Such a rate of tax on corporation incomes would severely penalize all small shareholders. An excess-profits tax designed to yield the same amount of additional revenues might be feasible, though its administrative difficulties would undoubtedly be serious; but there is every reason to believe that the subcommittee's proposal possesses the essential merits of such a tax without its administrative difficulties.

In conclusion, I should like to state that it is my opinion that the proposed new method of taxing corporation incomes provides the basis for an excellent and productive revenue measure. Its merits are clear. First, it would remove great existing inequalities in the taxation of incorporated and unincorporated business. Second, it would increase the Federal revenues mainly by removing important sources of tax avoidance, rather than by increasing existing tax rates or imposing new taxes. Finally, this proposal appears to be greatly superior to all alternative proposals that have been suggested.

Estimated number of individuals and distribution of individual net income by net income classes, calendar year 1926

Net income classes (thousands of dollars)	Number of individuals				
	Taxable under present law	Additional taxable [1]	Nontaxable under present law	Additional nontaxable [1]	Grand total
1 to 2	873,000	18,772	11,313,228	44,000	12,249,000
2 to 3	430,000	21,206	1,110,794	44,000	1,614,000
3 to 4	472,000	24,530	401,170	32,000	960,000
4 to 5	317,000	26,494	147,506	31,000	522,000
5 to 10	355,711	63,868			420,579
10 to 25	163,080	12,203			175,192
25 to 50	40,350	15,232			55,582
50 to 100	13,544	3,717			17,261
100 to 150	2,103	2,876			4,979
150 to 300	1,709	793			2,502
300 to 500	375	786			1,161
500 to 1,000	212	400			612
1,000 and over	89	212			298
Total	2,687,708	191,302	13,031,698	181,000	16,051,708

Net income classes (thousands of dollars)	Net income (in millions of dollars)				
	Taxable under present law	Additional taxable [1]	Nontaxable under present law	Additional nontaxable [1]	Grand total
1 to 2	1,379	30	16,968	66	18,443
2 to 3	1,235	57	2,778	110	4,180
3 to 4	1,787	94	1,514	112	3,507
4 to 5	1,550	120	800	90	2,440
5 to 10	2,499	538			3,037
10 to 25	2,445	306			2,751
25 to 50	1,371	675			2,046
50 to 100	933	361			1,294
100 to 150	252	364			617
150 to 300	282	236			518
300 to 500	140	317			457
500 to 1,000	143	280			423
1,000 and over	183	607			792
Total	14,181	[2] 4,015	22,059	[2] 383	40,583

[1] Assuming that all corporate earnings were distributed.
[2] Exclusive of $370,000,000, the estimated additional amount which would be distributed to tax-exempt institutions, etc.

Mr. HILL. Mr. Helvering, will you take up this table?

Mr. HELVERING. I would like, Mr. Chairman, in connection with my statement, to explain the table that we have prepared. We have prepared it on a larger scale, and we have also prepared small tables to submit to the members of the committee.

The CHAIRMAN. The Chair feels sure that the committee will be glad to have an explanation of that table, as suggested by the witness.

Mr. HELVERING. Mr. McLeod will explain the table.

STATEMENT OF A. S. McLEOD, STATISTICIAN, UNITED STATES TREASURY DEPARTMENT

The CHAIRMAN. State your name to the reporter, and the capacity in which you appear.

Mr. MCLEOD. I am A. S. McLeod, statistician of the Treasury Department.

The CHAIRMAN. You may proceed.

Mr. McLEOD. Mr. Chairman, the table and this chart showing the estimated number of individuals and the distribution of individual net income by net income classes, for the calendar year 1936, was prepared in order to demonstrate to the committee how a large increase in Federal revenue would result from a complete distribution of corporation profits to shareholders. In the upper half of the chart, on the left-hand side, are shown the income classes, and on the horizontal scale is shown the amount of income in billions of dollars.

Mr. VINSON. Mr. Chairman, for the purposes of the record, I suggest that the table or chart be included in the record at this point.

The CHAIRMAN. Without objection, it is so ordered.

(Said chart is on file with the committee.)

Mr. McLEOD. There is shown here the estimated distribution of individuals and of taxable income for the calendar year 1936, under the present law, as estimated for the Federal Budget. There is also shown the estimated additional number of individuals and the additional amounts of individual income which would result from a complete distribution of corporation earnings to the shareholders.

The first bar of the upper half, opposite "Income classes", indicates incomes from $1,000 to $2,000 and we estimate that under the present law, in the calendar year 1936, there would be $1,400,000,000 of taxable income in this income class. Then, under the proposed tax, should complete distribution be made, we estimate that $30,000,000 of additional taxable income would fall in the income class of from $1,000 to $2,000, as indicated by the black section of the bar, from about $17,000,000,000 of estimated net income which is nontaxable under the present law.

Now, in the lower half of the chart, opposite the same income class, $1,000, to $2,000, we show the number of individuals who would be taxable under the present law, and the additional number who would be taxable after the distribution of all corporate earnings.

The double hatched section of the bar shows that under the present law we estimate that $873,000 individuals would be taxable in the income class from $1,000 to $2,000, that 19,000 additional individuals would become taxable and that 11,300,000 individuals would be nontaxable in that income class.

In the next income class, which is from $2,000 to $3,000, we estimate, as indicated by the upper section of the chart, that in addition to the $1,200,000,000 of taxable income under present law, approximately $57,000,000 of income would become taxable in that bracket, and $2,800,000,000 would remain nontaxable.

As to the individuals in that particular bracket, under the present law, we estimate that 438,000 are taxable, and, as a result of the proposed bill, if all corporate earnings were distributed, 21,000 additional individuals would become taxable, while 1,100,000 individuals would remain nontaxable.

In the next income bracket, that between $3,000 and $4,000 we have estimated that about $1,800,000,000 of income would be taxable under present law, and that as a result of complete distribution of corporate profits $94,000,000 of additional income would become taxable, while $1,600,000,000 of income would be nontaxable.

Mr. HILL. Does the black bar indicate the nontaxable?

Mr. McLEOD. The black bar indicates the additional taxable income which would result from the proposed bill if all corporate earnings were distributed.

Mr. TREADWAY. Mr. Chairman, would it not be well to have Mr. McLeod describe those bars? I suggest that because, of course, these colors are not going into the record.

Mr. HILL. I suggest that when Mr. McLeod comes to revise his remarks he describe the bars as they appear in the printed record, rather than on this chart, so that anyone reading the record can follow it.

Mr. McLEOD. Rather than describe the chart.

Mr. HILL. You may describe the chart now, but when you come to revise your statement, describe the colors of the bars as they will appear in the record.

Mr. McLEOD. I will do that.

Mr. VINSON. Let me suggest that we have accompanying the chart a very clear legend that we can easily follow. For instance, the criss-cross portion indicates net income under the existing law, and the black indicates the additional net income under the proposed law. Then the diagonal stripes indicate the net income that is nontaxable under the present law. Is not that correct?

Mr. McLEOD. Yes, sir.

Mr. BACHARACH. I do not quite understand the chart. We have the individuals of each class, but whether they actually agree with the statement you have read there about the present number and the estimated additional number, is not clear. I cannot quite see that.

Mr. McLEOD. Do you mean the present number as compared with the additional number?

Mr. BACHARACH. I mean as it appears on your chart itself.

Mr. McLEOD. This smaller chart indicates it.

Mr. BACHARACH. What I have in mind is the fact that while you are taking this up by each bracket, it seems to me that it would be better to show the present number in each one of those brackets, rather than these totals. You could give the totals as well, of course. For instance, you state that in the bracket from $25,000 to $50,000, there are at present 40,350 individuals, while the estimated addition is 15,233, making a total of 55,583. It seems to me you should show that net increase.

Mr. McLEOD. That would be the increase in that bracket.

Mr. BACHARACH. It would relieve the committee of the necessity of going over the whole proposition at a later time and looking up each individual bracket if it were indicated in that way. I think you could do that very easily.

Mr. McLEOD. Mr. Bacharach, we have in the bars the present number corresponding to the double-hatched section and the number indicated by reason of the bill in the black section, and the number nontaxable in the single-hatched section. Then below that bar we have the total number of individuals in that particular bar. Is that what you had reference to?

Mr. BACHARACH. No; I did not have reference to that. Apparently I did not make myself very clear about it. What I have in mind is that the present number of persons and the additional should be given after each bracket, just as it is given at the end. If you had it after each one, I think that would make it very much easier to follow. While it is easy enough now for members of the committee who are acquainted with it, and I have no criticism about what you are doing now, it was my thought that we should have a very clear

statement as to each one of them; for example, for the benefit of people who are interested only in certain brackets.

Mr. VINSON. Will the gentleman yield?

Mr. BACHARACH. Of course.

Mr. VINSON. I think the suggestion of the gentleman from New Jersey as to the chart is a good one; but I may also add that page 17 of Mr. Helvering's statement gives it in figures per bracket.

Mr. BACHARACH. I think that is absolutely correct. I understood that; but what I am talking about is just in reference to clearness, so that individuals who are not here, and are only interested in certain brackets, may have some idea as to whether they are in the $25,000 to $50,000 class or in the $5,000 to $10,000 class.

The CHAIRMAN. The Chair hopes that when the witness corrects his testimony that will appear in the record so as to clarify it as much as possible, not only for the benefit of members of the committee, but for others who may hear the testimony.

Mr. BACHARACH. That is all I have in mind, Mr. Chairman.

Mr. MCLEOD. In the next income class, $4,000 to $5,000, we have estimated under the present law, for the calendar year 1936, that $1,600,000,000 would be taxable; that as a result of the proposed bill, assuming complete distribution of corporate earnings, $129,000,000 of additional income would fall in that bracket and $666,000,000 would remain nontaxable.

In the lower section of the chart, for the corresponding bracket, we have estimated under the present law that 317,000 individuals would be taxable; that with complete distribution 26,000 additional individuals would become taxable and that 148,000 would remain nontaxable.

In the next bracket, which has a broader range, $5,000 to $10,000, we estimate that $2,500,000,000 would be taxable under the present law and that $538,000,000 additional income would be taxable under the proposed bill. There would be no nontaxable income in that group, or practically none. The number of individuals in that class taxable under the present law is 366,000. As a result of the proposed change in the law 64,000 additional individuals would become taxable in that particular bracket.

In the next bracket, $10,000 to $25,000 of income, we estimate $2,400,000,000 would be taxable under the present law, and an additional taxable income of $306,000,000. The number of taxable individuals in the same bracket under the present law is estimated to be 164,000. As a result of complete distribution of corporate income, 12,000 additional individuals would become taxable in that class.

In the next class, $25,000 to $50,000 income, we estimate $1,400,000,000 of taxable income under the present law, and under the proposed change $675,000,000 additional income would be taxable in that bracket. The number of individuals in the same bracket under the present law would be 40,350 taxable, and an estimated additional number of 15,233 individuals, or a total of 55,583.

The next bracket, $50,000 to $100,000 of income, we estimate under the present law $913,000,000 of taxable income and an additional amount under the proposed change of $381,000,000 of taxable income. The number of individuals for the corresponding bracket under the present law is estimated at 13,544; the estimated additional number to become taxable is 3,717, or a total of 17,261.

In the next bracket, $100,000 to $150,000 of income, we estimate under the present law $252,000,000 of taxable income and under the proposed change $365,000,000 of additional taxable income.

In the corresponding bracket the number of individuals estimated to be taxable under present law is 2,103, and the estimated additional taxable individuals are 2,876, or a total of 4,979.

In the next bracket, $150,000 to $300,000 income, we estimate under present law $282,000,000 of taxable income, and under the proposed change $236,000,000 of additional income would be taxable. The present number of individuals in that particular bracket of $150,000 to $300,000 is estimated at 1,398, and the estimated additional individuals are 705, or a total for that class of 2,103.

In the next income class of $300,000 to $500,000, we estimate under present law $140,000,000 of taxable income, and under the proposed change $317,000,000 of additional income as taxable. The number of individuals in that bracket under present law is 375; the estimated additional number is 786, or a total of 1,161.

In the next income bracket, $500,000 to $1,000,000, we estimate under present law $143,000,000 taxable income, and as a result of the proposed change $280,000,000 of additional income would become taxable. The number of individuals in that class is estimated under present law at 212, and the estimated additional number would be 400, or a total of 612 individuals.

For incomes over $1,000,000 we estimate under present law $185,000,000 of taxable income, and under the proposed change an additional taxable income of $607,000,000. The number of individuals would be, under present law, 86; under the proposed law an additional of 212, or a total of 298. Under the present law it is estimated that the 86 individuals would have an average income of $2,150,000, and under the proposed change the total number of individuals, 298, would have an average income of $2,660,000.

The significant factor in connection with this chart is that with complete distribution of corporate earnings an additional taxable income of approximately $4,000,000,000 would result and that only approximately 191,000 additional individuals would become taxable. It means that the present recipients of dividends would move into the higher income brackets as additional dividends were distributed to them.

Mr. REED. Mr. McLeod how many individuals who are not now taxed will be taxed under the whole set-up?

Mr. MCLEOD. 191,302 are estimated as additional taxable individuals.

Mr. CROWTHER. How many individuals will now pay the normal tax on dividends under this proposition?

Mr. MCLEOD. We do not have the exact number of individuals that would be receiving dividends; but it is probable that between 65 and 70 percent of the total number filing returns of over $5,000 are at the present time receiving dividends.

Mr. CROWTHER. I thought that the Treasury gave a figure of 2,800,000, or something of that sort.

Mr. MCLEOD. Of individuals?

Mr. CROWTHER. Yes.

Mr. McLEOD. That represents the total number of individuals estimated under present law to have taxable incomes. That would include all sources of income.

Mr. CROWTHER. You do not think that whole number would be involved in this, then?

Mr. McLEOD. No, sir.

Mr. VINSON. That number is 2,687,768, who would be taxable under present law.

Mr. TREADWAY. Is the chart that you are showing us an estimate of the total income of corporations distributed?

Mr. McLEOD. It represents the total income of corporations distributed plus income that would be received under present law other than dividends.

Mr. TREADWAY. The suggestion is not now, is it, to distribute all earnings of corporations? There is a reduction here—a cushion, so-called—in the subcommittee's report.

Mr. McLEOD. Of course the corporation has the option of distributing all or retaining certain percentages. This chart was originally prepared to show how incomes would be distributed if all corporate income were paid out to shareholders. Now, the relative proportion of the income as indicated by the black sections of the bars would not change greatly, unless it was all retained, of course.

Mr. REED. Mr. McLeod, take the top line there: The black represents the increased income under the plan, does it not?

Mr. McLEOD. That is right.

Mr. REED. Now, how many are taxed under the present law, in that first line?

Mr. McLEOD. Eight hundred and seventy-three thousand.

Mr. REED. Where does it show the additional number that will be taxed

Mr. McLEOD. That number is 19,000.

Mr. REED. All right; I have it now. Thank you, very much.

The CHAIRMAN. Are you through, Mr. McLeod?

Mr. McLEOD. I believe so.

Mr. McCORMACK. What is the estimated amount of revenue under the present law for the coming year?

Mr. McLEOD. For the individual income taxes?

Mr. McCORMACK. Take individual and corporate income taxes. In other words, assuming that the recommendations of the subcommittee went into effect, just what, in dollars and cents, would be the result?

Mr. McLEOD. Under the present law we estimate, from individual incomes, from corporate incomes, from the capital-stock tax and the excess-profits tax, $2,285,000,000 for the calendar year 1936.

Mr. VINSON. To break that down, the total of the corporate income tax, the capital-stock tax, and excess-profits tax is $1,132,000,000.

Mr. McLEOD. That is right.

Mr. VINSON. And the difference between your maximum and that figure is the present tax that individuals are paying upon dividends.

Mr. McLEOD. $1,153,000,000 for the calendar year 1936, is the estimated revenue from the individual income tax.

Mr. McCORMACK. I know what the figures are, but I want them for the record.

Mr. McLEOD. Now, under the proposed bill it is estimated that $591,000,000 of additional revenue would be received by the Federal Government.

Mr. McCORMACK. We have repealed certain laws with reference to corporations, or it is proposed to repeal them; that is true, is it not?

Mr. McLEOD. That is right.

Mr. McCORMACK. Then, in dollars and cents, what would be the effect of that?

Mr. McLEOD. You mean on the amounts repealed?

Mr. McCORMACK. Yes.

Mr. McLEOD. On the amounts repealed we would lose $168,000,000. That would be the capital stock tax and the excess profits tax.

Mr. McCORMACK. Then there would be a loss from certain corporation income taxes, would there not?

Mr. McLEOD. We would lose an additional amount of $964,000,000

Mr. JENKINS. How does the percentage of increase there run with reference to the present law? Does the percent of increase keep down pretty regularly? It seems to me that in one of your tables there is a tremendous jump. You get an additional taxable income of $675,000,000 from the $25,000–$50,000 people. That $675,000,000 is a pretty big jump. Is the percentage rate true right straight down the line?

Mr. McLEOD. You cannot compare the percentage changes from bracket to bracket, because the brackets do not have the same intervals between them; that is, the same amount of income as between brackets. They are not uniform in size. One bracket has a range of $15,000; the next bracket has $25,000; the next bracket has $50,000.

Mr. JENKINS. That is what I am coming to. For instance, between $10,000 and $25,000, or a range of $15,000, you have an increase of $306,000,000.

Mr. McLEOD. That is right.

Mr. JENKINS. The next bracket, $25,000 to $50,000, with a spread of $25,000, gives you an increase of $675,000,000. In preparing your schedule, in other words, have you had in mind any special percentage of increase?

Mr. McLEOD. No, sir. We have distributed these dividends on the basis of past experience, between the various brackets. The present recipients of dividends would be the individuals who would receive the additional amounts of dividends by reason of increased corporate distribution of earnings.

Mr. VINSON. In your estimates I note that you have estimated, and were compelled to estimate, for the year 1935, and then also estimate for 1936, in arriving at the estimated revenue yield under the proposed system. Is that correct?

Mr. McLEOD. We did not estimate the amounts of revenue that would result from this plan for the calendar year 1935.

Mr. VINSON. I did not say that, Mr. McLeod. I said—or at least I meant to say—that in arriving at the estimated revenue yield under this proposed plan you originally estimated the increased income tax yield for 1935, under the existing law, and also the increase in the 1936 income tax yield.

Mr. McLEOD. That is right.

Mr. VINSON. Now, since that was done, what have you learned from the returns that have been made for the taxable year 1935 in respect of the Treasury estimates—your estimates for that taxable year?

Mr. MCLEOD. We made our estimates of revenue for the calendar year 1935, the collections of which would be reported in March of this year; and collections to date, during March, show that the estimates are off nine-tenths of 1 percent.

Mr. VINSON. Which way?

Mr. MCLEOD. We are over nine-tenths of 1 percent.

Mr. VINSON. In other words, the estimates that you made for the taxable year 1935 in respect of increased income tax yield under the present system were approximately nine-tenths of 1 per cent less than that which apparently will come into the Treasury?

Mr. MCLEOD. I would prefer to say that the actual receipts were nine-tenths of 1 percent over the estimate.

Mr. VINSON. Well, that is the same thing.

Mr. MCLEOD. Yes, sir.

Mr. VINSON. In other words, with the returns that have come in and the yield that you now have, you do not have any fear as to your estimates for 1935 having been exaggerated, or too large?

Mr. MCLEOD. No; I think not.

Mr. VINSON. In other words, they were, if anything, conservative?

Mr. MCLEOD. That is right.

Mr. VINSON. So that leaves you just the one taxable year, 1936, for which you have to estimate?

Mr. MCLEOD. That is right.

Mr. VINSON. Mr. McLeod, you submitted to the subcommittee a memorandum under the heading "Estimated revenues under proposal to tax undistributed corporated profits," which, as I see it, gives the bases upon which you make your estimate for the additional yield of revenue. I would like for you to include that estimate in the record at this point, and following it a table showing corporate statutory net income and dividend distribution running from 1923 through 1936.

The CHAIRMAN. Without objection the witness will be given permission to insert any of the data suggested, and any other data, and to extend his remarks in any way that he thinks will be helpful to the committee.

(The statement requested is as follows:)

ESTIMATED REVENUE UNDER PROPOSAL TO TAX UNDISTRIBUTED CORPORATE PROFITS

It is estimated that if a tax on undistributed corporate profits were imposed, accompanied by the repeal of the present corporate income, capital stock, and excess profits taxes, and the elimination of the present exemption of dividends from normal tax, the net increase in revenue based on calendar year 1936 incomes would be about $620,000,000. The following table summarizes the basic data underlying this estimated increase:

Estimate of taxable base and revenue, calendar year 1936—corporations showing net income

[In millions of dollars]

1. Statutory net income		7,200
2. Taxes included in (1) to be repealed:		
Capital-stock tax		[1] 163
Excess-profits tax		5
3. Dividends received not included in (1), 90 percent of total dividends received		1,000
4. Aggregate taxable income		8,308
5. Cash dividends paid		3,540
6. Withheld earnings, (4) less (5)		4,768
7. Estimated tax on (6), assuming distribution to individuals, plus normal tax on present dividends		1,752
8. Loss in revenue from repeal of corporate income, capital-stock, and excess-profits taxes		1,132
9. Net increase in revenue		620

[1] Total estimated capital-stock tax of both net income and deficit corporations, $163,000,000.

Corporate statutory net income and dividend distribution

[In thousands of dollars]

Years	Statutory net income	Total cash dividends paid, all corporations	Dividends received, all corporations	Net cash dividends paid, all corporations	Total cash dividends paid by corporations showing net income	Net cash dividends paid, by net income corporations
1923	8,221,529	4,160,118	870,088	3,290,030	3,820,620	
1924	7,590,652	4,338,823	915,216	3,423,607	3,994,991	
1925	8,563,684	5,159,475	1,175,481	4,013,994	4,817,301	
1926	9,673,403	5,943,293	1,506,154	4,439,139	5,530,211	
1927	8,981,894	6,425,176	1,658,078	4,765,100	5,785,470	
1928	10,617,741	7,073,721	1,916,671	5,157,052	6,585,169	
1929	11,653,886	8,335,662	2,593,632	5,762,030	7,841,802	
1930	6,428,813	6,202,241	2,571,221	5,631,020	6,841,050	
1931	3,682,208	5,151,082	1,969,229	4,181,853	5,871,980	2,640,000
1932	2,152,113	3,885,601	1,259,982	2,625,619	3,220,386	1,570,000
1933	2,985,972	3,127,459	1,025,769	2,101,750	2,985,899	1,600,000
1934 [1]	4,220,000	3,300,000	1,025,000	2,275,000	2,540,000	1,750,000
1935 [1]	5,500,000	3,600,000	1,120,000	2,480,000	2,960,000	2,000,000
1936 [1]	7,200,000	3,900,000	1,200,000	2,700,000	3,340,000	2,430,000

[1] Estimated.

Mr. DISNEY. In your estimate of $2,000,000,000 more, for example, from a certain number of individuals, are you assuming that all corporate earnings would be distributed?

Mr. MCLEOD. In that particular distribution that is true. Of course, we have not based the estimate made for the subcommittee on 100-percent distribution. This is merely to show the relative distribution of income with increasing amounts distributed by corporations, and where it would fall, which, of course, is largely in the high surtax brackets.

Mr. MCCORMACK. That is about 100-percent distribution?

Mr. MCLEOD. That is right.

Mr. HILL. If you do not have 100-percent distribution, under the plan proposed, of the tax on the net income based upon the amount retained, you get a comparable amount from the corporation?

Mr. MCLEOD. That is right, approximately up to a certain point, and beyond that you would get additional amounts.

The CHAIRMAN. Under the subcommittee's proposal or recommendation, as I understand it, a corporation can distribute all or none or any part of its earnings, at its option, and the tax will be based upon the size of the earnings and the amount of the distribution; is that correct?

Mr. MCLEOD. That is correct.

Mr. BACHARACH. Mr. Chairman, as I understood the proposition at a meeting of the subcommittee, it did not make any difference whether it was distributed or whether it was not distributed; the amounts were practically equal.

Mr. MCLEOD. There were slight differences for smaller amounts distributed than it would be for larger amounts, but they were approximately the same. There were some differences.

Mr. BACHARACH. It would not be a substantial amount in dollars?

Mr. MCLEOD. As a result of changing the rate schedule on the smaller corporations, we estimated a decrease in revenue of $29,000,000.

Mr. BACHARACH. But if, for instance, instead of distributing to the individual, they would keep a larger proportion in the corporation, you would then get more money into the Treasury?

Mr. MCLEOD. If the corporations retained, say, in excess of 30 percent, a larger amount of revenue would be received.

Mr. BACHARACH. A larger amount for the Government?

Mr. MCLEOD. That is right.

Mr. BACHARACH. That is what I understood.

The CHAIRMAN. Are there any further questions by any member of the committee? If not, Commissioner Helvering will please return to the stand to answer any questions the committee may wish to ask.

STATEMENT OF MR. HELVERING—Resumed

Mr. CROWTHER. Mr. Commissioner, on page 12 of your statement, the first paragraph, after setting forth the amounts that have been allowed under the present law for deductions, the statement closes:

> In other words, the liberal provisions of the law with respect to deductions for depreciation and depletion—provisions which would be retained under the new plan—already permit very substantial operating reserves free from taxation.

The question I want to ask you is this: They have always been considered very proper deductions, have they not?

Mr. HELVERING. Oh, yes.

Mr. CROWTHER. Then there is no special advantage in the suggestion in that paragraph that there are already allowed very liberal deductions. Such deductions have always been considered eminently fair and equitable, have they not?

Mr. HELVERING. Well, I think they are liberal.

Mr. CROWTHER. Yes; I should think so from the statement.

Now, I have not any great criticism to offer of this report. I think it is a pretty fair statement of the facts, except that the President's name appears here 10 times: "President's proposal", "President's recommendation", "President's proposal", "the President's message." I suppose that is all right, but I would rather have seen the word "administration" used there a good many times.

Now let me ask you this. It seems to me this is a very naive statement here:

> There is no intention or desire whatever to interfere with the internal management of business enterprises. The object of the proposed revenue measure is not to tell corporate management what proportion of earnings they shall distribute and what proportion they shall retain.

However, is it not a fact that under what might be well termed "pressure rates", we are, in a sense, compelling corporations to distribute? Is not that a fair statement?

Mr. HELVERING. Well, of course, Mr. Crowther, that statement was occasioned to a certain extent by the continued attack made as to the inability to create reserves.

Some gentlemen appeared in my office and kept talking to me about "plowing back" reserves. Not being conversant—and perhaps I should be—with the term "plowing back", I tried to bring out, as I did here, that in a period of 3 years a corporation could, without increasing the present tax, if they bear their proportionate part of the burden, increase their reserves 100 percent in a period of 3 years, that they could, using their term, by "plowing back", get a very substantial reserve. But so far as that term is concerned, when we talk about plowing we talk about plowing under, to fertilize the soil.

Mr. CROWTHER. That is one of Mr. Wallace's terms.

Mr. HELVERING. I did not understand the significance of this word that they kept pushing at me, about plowing back certain reserves.

I am trying to bring out the fact that with all these liberal provisions, with the provision for charging off bad debts, which amounts to a tremendous sum, and then with the further privilege under this new proposal as to plowing back, it would amount to almost 100 percent of income in 3 years. So I do not see but what we do furnish them a cushion. It is not a feather bed, but it is a cushion, and I think a very reasonable one.

Mr. CROWTHER. Of course, you have not softened a cushion for the individual stockholders who have to pay the 4 percent normal tax.

Mr. HELVERING. No.

Mr. CROWTHER. You put some straw in their seat.

Mr. HELVERING. That is the source of the additional revenue.

Mr. HILL. The part that is distributed to the stockholders pays no corporation tax, hence there is no injustice in charging the stockholders the 4 percent normal tax, because under the present law the corporation pays the tax in lieu of the normal tax, but the amount that goes to the stockholder under this plan pays no corporate tax, so there is no injustice in charging the stockholders the normal tax on corporate earnings.

Mr. HELVERING. The stockholder is affected according to the size of the earnings he receives.

Mr. CROWTHER. That depends. Under the changed method as set up by Congressman Vinson, that might work out, but in the first plan the tax was to be paid out of the amount to be retained. Of course that has been changed, thanks to some members of the committee who saw the inequity in that proposition, and now it is going to be deducted from the shareholders, and reduce the distribution figures by that much.

Mr. MCCORMACK. Bearing on what Dr. Crowther asked you, Mr. Commissioner, about the statutory deductions from gross income, the

present law is not changed in that respect, and the present law is rather liberal in that respect, is it not?

Mr. HELVERING. I think we are fair, and even liberal in the deduction allowed under the present law.

Mr. MCCORMACK. Have you seen the report of the United States Steel Corporation for the fiscal year ending December 31, 1935?

Mr. HELVERING. No; I have not.

Mr. MCCORMACK. I have it before me, and it shows a gross income from operations of $758,893,126 operating charges, and so forth, $700,932,000 plus, leaving gross operating proceeds of $57,960,000 plus. Other income from other sources, such as rentals, and so forth, amounting to $5,476,000, out of which there are other charges of $2,900,000 leaving $2,570,000, plus, with a net operating income before charges for depreciation and interest, $60,536,000; allowances for depreciation, depletion, and obsolescence, $47,722,177.58 leaving a balance of $13,314,634.29, which brings us to a net income available for dividends of $1,146,708.31.

I am not saying that is not reasonable and proper, but it indicates that the law is very liberal with reference to statutory deductions from gross income, when out of a gross income from all sources of $60,536,811.87, there is a deduction of $47,222,177.58 for depletion, depreciation, obsolescence with other charges, such as taxes, bringing the taxable income of the corporation to $1,146,708.31.

Mr. CROWTHER. I think in connection with the legislation of 1934, when we contemplated making some change in the method of figuring depreciation, the Treasury Department at that time told us that we need not make any change in the law, that they could get a very appreciable amount of new revenue by tightening up the regulations and the methods of administration of the depreciation section.

Has that resulted in an increase of considerable additional revenue from that source?

Mr. HELVERING. Yes; it has, but it has not run to the $85,000,000 estimated, in the first year. It was impossible to get, in the first year, all of the various companies and series of companies adjusted on the new schedule.

Mr. CROWTHER. But the Treasury Department has tightened up on the regulations and administration of portions of that section as regards depreciation?

Mr. HELVERING. Yes. You will recall that the committee was considering an arbitrary deduction of 25 percent after the Bureau had completed the regular run of depreciation as it had been computed, and then taking 75 percent of that as the proper depreciation. We appeared before the committee, you will recall, and showed, or endeavored to show to the committee what we were doing, to adjust these various classes of depreciation schedules and endeavored to show the committee the administrative difficulties we would have in arbitrarily enforcing a horizontal cut of 25 percent.

The committee consented to let us proceed with our procedure, and I think that has worked very satisfactorily. The first year it did not come up to what we might have gotten by arbitrarily taking off 25 percent.

Mr. CROWTHER. Will it come up this year, do you think?

Mr. HELVERING. Yes; I think it will.

Mr. DISNEY. In making these suggestions, Mr. Helvering, on pages 11 and 12 of this statement, it was not the Department's idea to open up this subject with a view to changing the method of depletion and the obsolescence allowance, was it?

Mr. HELVERING. No; what I was endeavoring to do, Congressman, was this, to show very clearly this constant drive at the proposed provision, that corporations could not have proper reserves and proper surplus, explaining the deductions they have from their incomes before we get around to the net income where it is to be either retained or distributed.

Mr. DISNEY. Your idea is to leave it as it is?

Mr. HELVERING. Yes; we would not want to see any change in that particular phase. There may be some minor adjustments in the general principle.

Mr. COOPER. Mr. Commissioner, is this a fair statement of the philosophy upon which this is based, and the purpose sought to be accomplished by the proposed plan, that corporations may conduct their business as they see proper, have surpluses and reserves as their business judgment may dictate to them, and that the statutory net income or the earnings and profits derived from that business should pass through the tax mill, like the net income of the rest of us?

Mr. HELVERING. That is the purpose; yes.

Mr. KNUTSON. Mr. Commissioner, what other countries use this method of taxation at the present time, or have used it? Have you any information along that line?

Mr. HELVERING. I have no information on that, Congressman.

Mr. KNUTSON. My information is that it has been used in Norway and Denmark and is not working very satisfactorily, in that it is operating against small corporations, a number of which have been compelled to go out of business during the depression because they did not have the reserves to carry them through, such as the bigger corporations had. Of course, if that is the case, in the next depression, if this law should go into effect, it would wipe out the small corporations and give the big corporations an absolute monopoly.

Mr. HELVERING. That is what I was trying to show that with these allowances for depreciation, depletion, obsolescence, and bad debts, we take care of them up to a certain point, and then, going beyond that, we allow them further by this plan, if it should be adopted and enacted, to be in a situation which would allow them to accumulate in 3 years at least 90 percent of the surplus without paying any more taxes than now, or by paying more than they do now, going to the next bracket, of 40 percent in the large corporations and the small ones, they could create in a little over 2 years earnings a hundred percent reserve. My contention is that you would not unduly clamp down on a corporation, considering the deductions I have mentioned, and giving them the privilege of paying lesser taxes than now, and creating 100 percent reserves in 3 years; and I am convinced that is a fair proposition.

Mr. KNUTSON. Have you any information as to the total reserves carried by all corporations in the United States at the beginning of the depression?

Mr. HELVERING. I have not the figures myself.

Mr. KNUTSON. If we could have the information at this time, I would like to know what that total is, and for myself I would like to know how heavily they have been drawn upon.

It is my information, in connection with the lumber industry, that there are several big concerns that have gone into receivership during this depression because they had insufficient reserves to carry them through, and I presume that is true of other corporations. We would not want to create a condition that would result in general bankruptcy in the United States.

Mr. HILL. Will the gentleman yield?

Mr. KNUTSON. Yes.

Mr. HILL. Those were conditions under the tax laws as they now exist. The proposed law does not make it any more difficult for those concerns to build up reserves, at the same cost in corporate taxes, than under the present system.

Under the proposed plan here, if a corporation is unfortunate enough to have to go into receivership, it would be an easy problem for them by putting them on a straight 15-percent basis during the time of the receivership, and not put a tax upon whatever is undistributed.

Mr. KNUTSON. In other words, this law would provide for sending flowers to the deceased.

Mr. HILL. They die, according to the gentleman's statement, under the old plan. I do not think the mortality will be any greater under the new plan.

Mr. KNUTSON. Did the subcommittee look into the operation of this plan in the two Scandinavian countries?

Mr. HILL. It did not, but I think it would be very enlightening to the committee if the gentleman from Minnesota would set out in his remarks what those plans are, in comparison with the plan we are proposing here, and whether or not Norway and Denmark are continuing their plans, if they have had the disastrous results which the gentleman from Minnesota indicates.

Mr. KNUTSON. I am asking for information.

Mr. HILL. We did not consider those plans, and I personally did not know they had any such plans. I do not know how they would compare with this proposition.

The CHAIRMAN. Is there anything in this proposition that would prevent those corporations which did not now have reasonable reserves from building up reasonable reserves without paying unreasonable taxes.

Mr. HELVERING. Mr. Chairman, on the bottom of page 12 of this statement you will note that it is stated that a small corporation would pay a tax of 7½ percent of its adjusted net income, if it retained for surplus 30 percent of its adjusted net income, and its tax rate would be only 13 percent if it retained for surplus an amount equal to 40 percent of its adjusted net income, and it would be taxed less than the present tax.

Mr. REED. I want to submit to Mr. Hill, in regard to Norway, that as I understand the plan, over a period of 3 years they have had with the tax a very liberal provision for depletion and obsolescence, and their tax has run quite high on the undivided profits, and they have been reducing it, and there is great pressure on the part of business interests to reduce it further because it is bringing about a new extension of business. I suggest that for your information.

Mr. HILL. Does the gentleman know what their rates were?

Mr. REED. Yes. I know they started around 10 percent, and then they gradually had to lower them.

I want to get full information, because I think the committee would really be interested in seeing what has happened in Norway.

I wanted to be clear with regard to the pressure in connection with the distribution of net profits.

I do not know where the pressure is coming from, but Professor Tugwell has written a book on the Industrial Discipline, which seems to be in conformity with the recommendation that has been made here. He says:

> The question immediately arises * * * do we actually need this instrument (capital)? * * * why are prices so high or incomes so low that they (consumers) cannot buy what they wish? This evidently cannot be answered completely, but even a partial explanation seems to involve reference to our inexpert allocation of capital. * * * The first step in control would be to limit self-allocation. * * * In general the principle invoked would be to drive corporate surpluses into the open investment market; * * * It will be seen, then, that the control of investment is not so complex a matter, at least in principle, as it might at first seem. The principles involved would be only two: The forcing of all investment funds into an open market, and the regulating of new capital issues. Neither of these seems impossible if we grant (1) the substitution of Federal for State incorporation, and (2) the correctness of using the taxing power to force surpluses into the market.

So evidently he is quite in harmony with this recommendation.

Mr. CROWTHER. Mr. Chairman, I ask permission to read a very short paragraph from an article that I have here. I want to show that all of the brain trusters do not think alike. This article is by Raymond Moley. Vincent Astor is the publisher of this paper, and Raymond Moley is the editor. He says in the course of this editorial, which is entitled "Toward Insecurity", as follows—and I would like to have this follow Mr. Reed's insertion of a statement by Mr. Tugwell:

> To force industry to pay out all of its earnings in good years will, of course, have the effect of accentuating booms. And in years of depression, industry will find itself without means of paying for current operations—in plainer words, without money to meet the pay roll. Had American industry entered this depression stripped of all surpluses, scores of the biggest of corporations could not have survived.

The CHAIRMAN. Without objection, that may be inserted in the record as indicated.

Of course, there is no suggestion that they would be forced to do any such thing. That is just a comment that is thrown out for which there is not the slightest foundation. No such course has ever been suggested. No one has suggested that they pay out all of their earnings. The doctor knows that. My good friend knows that there is no such suggestion in the report of the subcommittee.

Mr. REED. One thing more, in connection with Mr. Knutson's question. The best figures I have been able to get covering all United States corporations give the profits from 1921 to 1933, after deducting taxes, amounting to $40,913,000,000, and cash-dividend payments actually exceeded these earnings by 10 million, which considering the 25-percent basis, would make $56,722,000,000. If you are going to put the figures in the record in response to Mr. Knutson's question, I would be interested to know whether the figures I have recited are correct.

Mr. BACHARACH. Assuming that this present tax law, or the new tax law that we are considering had been in effect during a depression year, say in 1932, what do you think would have been the effect as to receipts under the new proposition?

Mr. HELVERING. I could not answer that question.

Mr. BACHARACH. You must have the figures for 1932 and 1933. The Treasury Department must be afraid of those figures.

Mr. HELVERING. I have not the exact figures. We could possibly supply them.

Mr. BACHARACH. I wish you would supply them, because it is my impression you would find it would not bring in as much as under the present law.

Mr. WOODRUFF. All during the hearings which have been held in executive session by the subcommittee my mind has constantly gone back to certain statements that have been issued from time to time by the President of the United States, in which he called attention to the fact that investments made in tax-exempt securities by very wealthy people have resulted in their escaping taxation. You recall those statements?

Mr. HELVERING. Yes.

Mr. WOODRUFF. I think the publicity that has been given out in regard to this bill has had as its purpose, at least in part, convincing the people of the United States that this was an attempt to compel the wealthy people of the United States to pay a larger share of the taxes than they have paid in the past. Is that one of the purposes of having this bill before us at this time?

Mr. HELVERING. I think that will be the result.

Mr. WOODRUFF. That is exactly what has been given to the country, and I am wondering if that is correct, because of the results of an investigation of the realtive income from investments in purely wealth-producing enterprises, the income of which is taxable, and investments in tax-exempt securities. I am wondering if that is true.

I have before me some figures I have prepared from this card issued by Prentice-Hall, Inc. I take it you are familiar with that.

Mr. HELVERING. I have seen it.

Mr. WOODRUFF. I assume the figures are substantially correct.

Mr. HELVERING. I think so.

Mr. WOODRUFF. They disclose that a sum of money invested in productive enterprises that would produce a taxable income of $250,000 a year, if that income were to be taxed, the amount of the tax would be $128,294, leaving a net income of $121,706 on that investment; that the same sum of money invested in tax-exempt securities at 3½ percent—I figured this other sum here on the basis of 6 percent—that the same sum of money invested in tax-exempt securities at 3½ percent would net the taxpayer $143,892, and provide for him an inducement of $22,186 per year to go back and take the money out of productive enterprise and put it into tax-exempt securities.

These figures also show that on a sum invested that would produce $500,000 a year, taxable, the income tax is $304,144, giving a net income of $195,856 after payment of taxes. That same sum of money invested in tax-exempt securities would give an income of $291,666 and provide an inducement of $95,810 to invest his money in tax-exempt securities. And if that sum were invested that would be $1,000,000 a year, taxable, the tax would be $697,044, leaving a net income after tax of $320,966. If the same sum were invested in tax-exempt securities it would result in an income of $583,333 and

provide an inducement of $262,377, and with absolutely no risk. They take no chance on their investment.

There are no hazards in connection with carefully selected tax-exempt securities. In the case of an investment producing a taxable income of $2,000,000 the inducement is $1,115,685. In the case of an investment producing a taxable income of $5,000,000, if that money were invested instead in tax-exempt securities, there would be an inducement of $1,705,660. I will insert the complete figures at this point as I have hurriedly worked them out:

Taxable income derived from investment at 6 percent	Tax	Net income after tax	Yield from investment of same capital in 3½ percent bonds	Inducement to invest in tax-exempt bonds
$250,000	$128,294	$121,706	$143,892	$22,186
$500,000	304,144	195,856	291,666	95,810
$1,000,000	679,044	320,966	583,333	262,367
$2,000,000	1,449,019	550,981	1,666,666	1,115,685
$5,000,000	3,788,994	1,211,006	2,916,666	1,705,660

Does any one imagine that the business people of this country are going to continue to invest their money in productive enterprises if they are being constantly forced into higher brackets? Instead of getting more money from the rich you are going to get less of it, and taxes have to be raised somewhere, and the less that the rich pay the more the poor have to pay.

Mr. HELVERING. What did you say the amount is on a million dollars?

Mr. WOODRUFF. It is $262,177, according to my figures.

Mr. HELVERING. Under the present law, anyone having that much income, under those conditions, would pay $641,000.

Mr. WOODRUFF. According to this schedule, on a million dollars of taxable income, a man would pay $679,044.

Mr. HELVERING. That is about right.

Mr. WOODRUFF. Leaving a net income of $320,956. That same sum of money invested in tax-exempt securities at 3½ percent would net the taxpayer $583,333, leaving as I said before, an inducement for that individual to put that money into tax-exempt securities of $262,177 per year.

I cannot imagine any business man being foolish enough to put his money in productive enterprises as long as that avenue of escape is open to him.

Mr. HELVERING. The same avenue is open right now.

Mr. WOODRUFF. I understand the same avenue is open right now, and I might say that for a long time there have been resolutions before Congress looking to the submission to the States of a constitutional amendment which will close that avenue of escape, provided the States could ever be brought to the state of mind that they would approve such a constitutional amendment.

Now, Mr. Commissioner, it is generally believed by the people throughout the country that all of the tax-exempt securities are issued by the United States Government. Of course, we know that is not true, and that it is far from the truth.

I wish you would put into the record at this point the amount of tax-exempt securities that have been issued by the Federal Government, when those securities were issued, so that we may give the people of the United States all of the information on this subject that we can.

Mr. HILL. You do not want all of the issues; you simply want those that are now outstanding, I assume.

Mr. WOODRUFF. Yes; those that are outstanding now.

Mr. DISNEY. Should not your table include the issues of municipalities and counties and States?

Mr. WOODRUFF. Mr. Commissioner, if you can get the information, you might add the amount of tax-exempt securities that are outstanding of States and various other political subdivisions thereof.

Mr. HELVERING. I think we can come close to it.

EXTRACT FROM THE ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF FINANCES FOR THE FISCAL YEAR 1935

TABLE 44.—*Estimated amount of securities outstanding, interest on which is wholly exempt from normal income tax and surtax of the Federal Government, June 30, 1913 to 1935, by type of obligor*

NET OUTSTANDING ISSUES[1]

[000,000 omitted]

Year	Grand total	States, counties, cities, etc.			U. S. Government	Territories and insular possessions	Federal farm loan system
		Total	Long term	Short term			
June 30—							
1913	$4,589	$3,887	$3,643	$244	$606	$36	.....
1914	5,245	4,242	3,966	276	967	36	.....
1915	5,652	4,644	4,336	308	969	39	.....
1916	6,058	5,049	4,709	340	970	39	.....
1917	8,127	5,371	4,999	372	2,711	45	154
1918	8,104	5,622	5,218	404	2,383	46	137
1919	8,925	6,051	5,615	436	2,701	46	231
1920	10,033	6,643	6,177	468	3,105	46	239
1921	10,519	7,268	6,788	500	2,927	57	267
1922	11,368	8,415	7,884	531	2,895	76	791
1923	12,378	9,015	8,557	458	2,985	118	969
1924	13,456	9,921	9,407	513	2,984	125	1,126
1925	14,089	10,975	10,280	695	2,965	127	1,384
1926	15,487	11,672	11,154	518	2,154	133	1,528
1927	16,587	12,610	12,070	540	2,154	138	1,685
1928	17,515	13,432	12,894	616	2,355	140	1,762
1929	18,423	14,358	13,423	935	2,157	140	1,767
1930	21,340	15,897	14,672	1,225	3,549	154	1,765
1931	23,768	17,457	15,990	1,466	4,284	148	1,279
1932	28,409	17,828	16,218	1,610	6,771	130	1,674
1933	28,556	17,072	15,876	1,196	9,765	131	1,588
1934	30,409	16,771	15,824	947	11,645	129	1,870
1935	31,283	16,805	15,810	1,085	12,491	118	1,471

[1] "Total outstanding issues" less "Held in U. S. Government trust funds, or owned by U. S. Government or by governmental agencies" and "Held in sinking funds."

TABLE 45.—*Amount of securities outstanding, interest on which is exempt from normal income tax, but not surtax, of the Federal Government, June 30, 1918 to 1935, by direct obligor*

NET OUTSTANDING ISSUES[1]

[000,000 omitted]

Year	Total	U. S. Government	Reconstruction Finance Corporation	Home Owners' Loan Corporation	Federal Farm Mortgage Corporation
June 30—					
1918	$0,586	$0,586	.....	.....	.....
1919	22,312	22,312	.....	.....	.....
1920	20,750	20,750	.....	.....	.....
1921	20,491	20,491	.....	.....	.....
1922	20,070	20,070	.....	.....	.....
1923	19,351	19,351	.....	.....	.....
1924	18,343	18,343	.....	.....	.....
1925	17,572	17,572	.....	.....	.....
1926	16,936	16,936	.....	.....	.....
1927	15,398	15,398	.....	.....	.....
1928	14,367	14,367	.....	.....	.....
1929	13,616	13,616	.....	.....	.....
1930	13,429	11,429	.....	.....	.....
1931	11,714	11,714	.....	.....	.....
1932	11,902	11,902	.....	.....	.....
1933	11,848	11,848	.....	.....	.....
1934	14,874	13,678	$235	$722	$239
1935	17,135	13,336	290	3,478	1,052

[1] "Total outstanding issues" less "Held in U. S. Government trust funds, or owned by U. S. Government or by governmental agencies." The U. S. Government and its agencies issuing this type of bonds maintain no sinking fund in which bonds are held alive.

Mr. WOODRUFF. I think that would be very enlightening.

Now, just between you and me—there is nobody else in on this—have you any idea, deep down in your heart, that you are going to be able to put your hands into the pockets of these rich men whom you are seeking to reach through the methods that you are now presenting? Do you think that you are going to be any more successful in that in the future than you have been in the past, in view of this avenue of escape that is open to them at all times?

Mr. HELVERING. Let me answer that first by saying that whenever there is a great demand for any particular security—and if these men were going out of production business to buy these securities, immediately the rates on all such securities would go down.

Mr. WOODRUFF. You would not suggest, would you——

Mr. HELVERING. I mean, as the demand increases, the rates on the securities would go down.

Mr. WOODRUFF. That is unquestionably true, but in view of the figures that I have cited to you, do you not believe that they could pay an advanced price for these securities and still make a lot of money each year by putting their investments into the tax-exempt class?

Mr. HELVERING. There is a certain point to which that would go and then it would start to react the other way. There is no question about that.

Mr. FULLER. Mr. Chairman, I would like to have the witness answer Mr. Woodruff's question, which I think is a very important question, and which the Commissioner has not answered; that is, whether or not he honestly thought that this bill would bring in the revenues contemplated, or anything like them.

Mr. HELVERING. I will say this. I think we have a wonderful staff down at the Commissioner's office, and if this bill is passed, I believe "confidentially", as Mr. Woodruff said——

Mr. DISNEY. Just between you and him.

Mr. HELVERING. Yes; that I will collect $591,000,000.

Mr. CROWTHER. The first year.

Mr. WOODRUFF. Let me ask you this, Mr. Commissioner: Is there anything to prevent any of these individuals, who look to the time when, in the not far distant future, they will be compelled to accept a lot of these dividends that are going to be thrown into their laps, from so arranging their investments as of the time when that occurs, to escape wholly or in part the penalty that you propose to put upon them by this bill?

In other words, what is to prevent their taking their money out of productive enterprise to the extent that it is necessary in order to escape this increased tax?

Mr. HELVERING. Well, I do not think the American people are so constituted that they are going, on account of the tax problem——

Mr. WOODRUFF. You do not think what, Mr. Commissioner?

Mr. HELVERING. That the American people are so constituted, on account of the tax problem, that they are going to sit around summer resorts, and places like that.

Mr. WOODRUFF. Let me ask you this, Mr. Commissioner. Have you ever known the time when people, especially those with large incomes, have not been exceedingly tax conscious?

Mr. HELVERING. More so perhaps than people with smaller incomes.

Mr. WOODRUFF. That is quite generally so, is it not?

Mr. HELVERING. Yes.

Mr. WOODRUFF. And it is a perfectly natural thing. If a man has money to invest and if by investing it in one particular thing he can get more money each year, or have more left after the tax gatherer has called on him than if he invested it in something else, what is the natural thing for him to do? It is just as natural as anything can be, as long as human selfishness and good business judgment remain what they are.

Mr. BUCK. Will the gentleman yield?

Mr. WOODRUFF. I yield to the gentleman from California; but first you may answer my question, Mr. Commissioner, if you will.

Mr. BUCK. If the Commissioner is not going to answer the question, may I ask this question?

Mr. HELVERING. I just wanted to observe, if all big taxpayers are going out of productive enterprise, somebody is going to come in and reestablish those productive enterprises.

Mr. WOODRUFF. Mr. Commissioner, that is not the point. The point is to get more taxes from these rich people. That is what the people of the country have been led to believe that this tax bill would do. That has been the important thing that has been put out to the public, to sell them on this particular tax bill. Personally, I do not think it is going to do anything of the kind. I think, as I told you in executive session, that you are going to be tremendously disappointed in the receipts that you get from this tax bill.

Mr. HELVERING. Only in the transition period from the old system to the new.

Mr. WOODRUFF. If you get anything at all out of this tax bill it will be during the transition period. You will not get it any time after that. You may get something the first year, but after that you will get nothing.

I now yield to the gentleman from California, Mr. Chairman.

Mr. DISNEY. Will the gentleman yield?

The CHAIRMAN. Has the gentleman finished?

Mr. WOODRUFF. I yield to the gentleman from California for a question.

The CHAIRMAN. If you have finished with the witness, I promised to recognize Mr. Lamneck next.

Mr. DISNEY. Mr. Chairman, I wanted to make an inquiry about the committee's procedure. May I inquire what the procedure is going to be, how long the committee is going to run before it recesses, and when we will meet again?

The CHAIRMAN. We thought we would run until we had finished with the present witness. If that is going to take any considerable time, we will recess at about 12:30 until 2 o'clock.

Mr. BUCK. Mr. Commissioner——

The CHAIRMAN. Has the gentleman from Michigan finished with the witness?

Mr. WOODRUFF. I yield the floor, Mr. Chairman.

The CHAIRMAN. The gentleman cannot yield the witness to someone else.

Mr. WOODRUFF. Mr. Buck has been asking me to yield now for some time.

The CHAIRMAN. I agreed to recognize Mr. Lamneck after you had finished.

Mr. BUCK. May not the gentleman yield to me for a question, Mr. Chairman?

The CHAIRMAN. When a member gets through with a witness, he cannot yield the floor to someone else. I agreed to recognize Mr. Lamneck first after Mr. Woodruff. If he is not here, I will recognize the gentleman from California.

Mr. BUCK. Thank you.

Mr. Commissioner, the questions that the gentleman from Michigan asked you and the statements that he has made may have a great bearing on the matter of the original investment at the moment. But is it not a fact that in the event that people who now have their money invested in productive enterprises decide to get out, because their income would be better protected by doing as the gentleman has suggested, they would, in disposing of their present assets, have to pay a capital-gains tax which would more than offset any saving that they would make?

Mr. WOODRUFF. Temporarily, perhaps.

Mr. HELVERING. That is true.

Mr. WOODRUFF. How about the years following?

Mr. BUCK. And those who would acquire their property would thereafter have to pay income tax on the earnings from that property. That is all I wanted to suggest, Mr. Chairman.

The CHAIRMAN. According to the picture that has been drawn by my friend, the able gentleman from Michigan, they could not dispose of their assets, there would be no buyers. If everybody wanted

to go out of the business, who would take over their stock, their interest in the business? And more than that, if they did, issues of Government securities would soon be exhausted, there would be such a rush for them, that the yield would become much smaller. So I cannot see any danger from that. It might work that way to a limited degree, for a limited time, but I cannot see any imminent danger of that.

Mr. HELVERING. I would say, Mr. Chairman, that the Treasury Department is willing to stand on the estimates that we have given you of the production of revenue.

The CHAIRMAN. And Congress will probably be in session, and if it should work out so disastrously, the situation can soon be corrected.

Mr. CROWTHER. Mr. Chairman, the statement has been made here once or twice—the chairman of the subcommittee made it a moment ago—that they could build up surpluses at no greater cost than they do now. That is true up to a certain point. I want to call the attention of the chairman of the subcommittee, Mr. Hill, to page 13 of this statement which says that corporations that directly retain from current revenues more than 40 percent in the case of smaller corporations, and more than 30 percent in the case of larger corporations, will pay higher taxes under the subcommittee's proposal than they pay under the present law. I wanted that cleared up.

Mr. COOPER. Will the gentleman yield there?

Mr. CROWTHER. I will be glad to yield.

Mr. COOPER. I am sure the gentleman will admit that the information presented to the subcommittee at the sessions—and the gentlemen from New York was every faithful and constant in his attendance—showed that now on the average the corporations throughout the country retain only about 30 percent. That is the present actual experience in the conduct of the affairs of corporations.

Mr. HILL. If you will allow a correction, 25 to 30 percent.

Mr. COOPER. Between 25 and 30 percent.

Mr. MCCORMACK. Mr. Chairman, I think that the gentlemen on both sides have probably been making statements rather than asking questions. I am including myself in that category. I think we can get along more quickly if we ask questions and do not make statements and speeches.

I will not make any motion now, but I intend to make a motion later if members of the committee continue to make speeches, that that be considered out of order. That applies to members on both sides, including myself. We are here to ask witnesses questions.

Mr. WOODRUFF. Will the gentleman yield?

Mr. MCCORMACK. I am through.

Mr. CROWTHER. Mr. Chairman, if that is directed at me——

Mr. MCCORMACK. No; it is not. The gentleman has a guilty conscience. I said that it applies to all.

Mr. CROWTHER. In all friendliness, I do not know of anyone who offends to a greater degree in making speeches than my good friend from Massachusetts, and they are very able speeches. He makes able speeches. They are very convincing.

Mr. MCCORMACK. I try to make my speeches on the floor.

Mr. CROWTHER. And I am sure that he would not deny the privilege to someone else.

Mr. MCCORMACK. The gentleman misunderstood me. I prefaced my remarks with a statement that this applies to nobody in particular, and the gentleman is possessed of a guilty conscience that is not warranted by the facts.

Mr. REED. Will the gentleman yield?

Mr. MCCORMACK. I am through.

Mr. CROWTHER. Having made his speech, the gentleman is through.

The CHAIRMAN. Are there any further questions?

Mr. HILL. Mr. Commissioner, the figure, $591,000,000 has been emphasized here. That is the estimate of what would be received from this new plan.

Mr. HELVERING. According to the rates suggested by the subcommittee.

Mr. HILL. Does that take into account the amount of money, after the plan should go into effect, for the first taxable year, that would be received from the capital-stock and excess-profits tax, of something like $80,000,000 or $83,000,000?

Mr. HELVERING. No.

Mr. HILL. So that that would be added to the $591,000,000, at least for the first taxable year?

Mr. HELVERING. Yes.

Mr. HILL. Then in recommendation no. 6 of the subcommittee's report, a tax is recommended on foreign corporations, at a flat rate of 22½ percent, to be withheld at source. As I recall it, it was estimated that that would yield about $25,000,000 more than we are now getting from foreign corporations; is that correct?

Mr. HELVERING. A total of about $25,000,000. We now collect about $3,000,000.

Mr. HILL. How much?

Mr. HELVERING. About $3,000,000.

Mr. HILL. There would be a gain, then, of about $22,000,000 there?

Mr. HELVERING. That income, that is of foreign corporations, is included in the $7,200,000,000, estimated income of all corporations, for the year 1936.

Mr. HILL. How did you get it in there when it was not in contemplation under the original proposal?

Mr. HELVERING. That is all corporations operating in the United States, as I understood from Mr. McLeod, included foreign corporations, to get the total net income.

Mr. HILL. But in making that estimate you took into consideration that you were getting about $3,000,000 and you probably carried that $3,000,000 right along in that estimate that you gave us at the outset.

The point that I am making is that by increasing this rate and withholding it at the source, and getting all the taxes, we would probably gain about $23,000,000?

Mr. HELVERING. Over our present collections; yes, sir.

The CHAIRMAN. Are there any further questions of the Commissioner?

Mr. HELVERING. Some member of the committee a few minutes ago asked about the present estimates. I would like to put in a statement, if the committee desires. The collections, as compared with the estimates for the fiscal year up to and including March 20,

The CHAIRMAN. Without objection, the data will be inserted in the record at this point.

(The statement referred to is as follows:)

Receipt from income taxes

(Amounts in millions of dollars)

Actual receipts		Estimated receipts July 1, 1935, to Mar. 21, 1936	Increase, fiscal year 1936 over fiscal year 1935 through Mar. 21		Increase actual receipts over estimated, fiscal year 1936 through Mar. 21	
July 1, 1934, to Mar. 21, 1935	July 1, 1935, to Mar. 22, 1936		Amount	Percent	Amount	Percent
760.9	1,002.5	992.1	241.6	31.7	9.2	0.9

Mr. CROWTHER. Mr. Chairman, one more question: I think I will withdraw it, Mr. Chairman, because it would be a statement.

The CHAIRMAN. Mr. Commissioner, if there are no further questions, we thank you and Mr. McLeod for your presence and the testimony you have given to the committee.

The Chair would like to make this observation. We have finished the testimony of the witnesses who were on the calendar for today. We have gotten through earlier than we contemplated.

If there are any witnesses either from Washington or from out of town who wish to be heard, who are ready to appear today, if they will confer with the chairman and give their names to the clerk of the committee, we shall arrange a schedule for this afternoon.

The committee will now recess until 2 o'clock.

(Whereupon, at 12:25, the committee recessed until 2 p. m.)

AFTER RECESS

The committee reconvened at 2 o'clock p. m., pursuant to the taking of a recess.

The CHAIRMAN. The committee will be in order.

The first witness on our calendar this afternoon is Mr. M. L. Seidman, representing the New York Board of Trade.

Mr. HILL. Mr. Chairman, Mr. Seidman and the next two witnesses, Mr. Weston and Mr. Bennet, each, I think has indicated that he will need about 15 minutes. Therefore, I suggest that the time of each gentleman be fixed at 15 minutes.

The CHAIRMAN. Without objection, it is so ordered.

The Chair would like to make this observation at this point: I have not seen the papers, but I understand that some article appears in the papers to the effect that we are not proceeding according to the previous custom, or under our previous rules with respect to the time allotted witnesses, making up the calendar, and so forth. The clerk has arranged for the time of the witnesses, and that is a responsibility that the chairman has never assumed. The time has been agreed upon, as has always been done, by consent of the committee. If any other impression has gone out, I would like to contradict it.

Mr. Seidman, you will state your name and the capacity in which you appear.

STATEMENT OF M. L. SEIDMAN, NEW YORK CITY, REPRESENTING THE NEW YORK BOARD OF TRADE

Mr. SEIDMAN. My name is M. L. Seidman, and I am representing the New York Board of Trade.

Mr. Chairman and gentlemen of the committee, in presenting to you the views of the New York Board of Trade on this proposal, I want to be helpful and contractive, not destructive. May I, therefore, request permission to submit my remarks in full, to their completion, and then, if there are any questions, I will be glad to answer them to the best of my ability.

The CHAIRMAN. You will have that privilege.

Mr. SEIDMAN. Gentlemen, it is quite generally recognized that Congress is now giving consideration to an undistributed profits tax on corporate net income, only because of the President's recommendation in his tax message of March 3, 1936. In that message, the President said on this subject in part as follows:

> I invite your attention * * * to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system, and stop "leaks" in present surtaxes.
>
> Extended study of methods of improving present taxes on income from business warrants the consideration of changes to provide a fairer distribution of the tax load among all the beneficial owners of the business profits whether derived from unincorporated enterprises or from incorporated businesses and whether distributed to the real owners as earned or withheld from them. * * *
>
> * * * Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, 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.

Thus, one of the two major inequities in our present tax system named by the President is the taxing of corporate profit on a different basis and at different rates than are profits derived from individual and partnership businesses. Also, one of the President's expressed purposes in the proposed change is to tax more equitably to the individual, corporate income whether distributed or not. What the President said, in effect, is this:

> It is the individual, not the corporation or the partnership, to whom the profit actually accrues—regardless of the form in which business is transacted. The law already recognizes this principle in the treatment of income derived from business conducted in partnership form. It is now proposed to extend the same principle to business conducted in corporate form. Since the individual, under the present law, is required to pick up in his own tax return the income from his single proprietorship business and his pro-rata share of income derived from a partnership, the requirement that he be also taxed directly or indirectly on his pro-rata share of income of a corporation in which he is a shareholder would thus serve to tax to the individual as a taxable unit, every dollar of business income, regardless of form in which the business is conducted.

If my interpretation of the President's statement is correct, and I believe it is, then such a tax plan, if adopted, would once and for all, make the individual the tax unit, and would at last abandon the fiction that the income of the corporation should itself be taxable as the income of a specific entity and as distinct from the actual ownership of such income by the corporate stockholders. The acceptance of such a principle of income taxation would recognize quite definitely, I believe, that the scheme adopted by the 1935 Revenue Act of taxing corporate income at progressive rates with mere size of the corporation as the yardstick, is ill-conceived and wrong in principle. Net income

of a corporation is in its ultimate effect, the income of so many individual stockholders. Therefore, the taxation of the individual, as a unit, for all business profits, whether accruing to him by virtue of direct ownership of a business or whether reaching him through a partnership or through a corporation is a tax principle which is fundamentally sound and has the unqualified approval of the New York Board of Trade.

The difficulty with adopting such a plan at this particular time—even if your committee were to make its own present proposals to conform with the President's plan, and it is my opinion, quite a distance from the residents' plan—is that the change is a revolutionary one from our present tax methods and those methods that have been followed by us for many years past and hence have become deeply embedded in our economic system. The change cannot possibly be adequately dealt with if it is to be done hastily, as would probably be the case if enacted by the present Congress in an election year. We must bear in mind that the taxing of corporation profits as is now proposed, would turn upside-down the established methods of producing Government revenue from corporate income. There would therefore necessarily have to be worked out a completely new system of income and tax interrelationship between the corporation and the individual.

In addition, your committee's recommendations are at serious variance with the President's proposals in that regard. To the extent that your recommendations contemplate treating the corporation merely as an agency for income distributions to the stockholder and thus taxing the stockholder and not the corporation on such distributions, the "equality of tax burden" to which the President refers will be well served. But the President extends this equality of taxation to "all corporate income whether distributed or withheld from distribution." Here is where your own recommendations are seriously at variance with his, and the adoption of your proposals would, we believe, result in gross inequality of imposing the tax burden.

Paragraph XVII of your recommendations reads as follows:

> It is recommended that no exemption from tax on the shareholder be given to dividends declared out of earnings and profits of a year in which the corporation has been subject to taxation under the new plan recommended under recommendation no. II.

This means that retained corporate income which under the proposed rate schedule is subject to tax at a rate as high as 73.9 percent will again be subject to tax when the remaining income, after the tax is paid, is ultimately distributed to the shareholders. That is a tremendous price for a business to pay for the right to retain working capital. The effective rate, even for a $10,000 income, is 42 percent.

Particular attention should be called to the fact that the proposed arrangement would give a distinct advantage to the prosperous, well-financed corporation and its stockholders. For, those corporations who have already accumulated ample reserves and who have the necessary resources can best afford to distribute all of their current earnings and thus completely escape the undistributed-profits tax. In their case, only the stockholders would pay a tax, whereas in the former case, both the corporation and the stockholders would pay, and on the same income or what is left of it. The difference in net tax results might in some cases be staggeringly against the small, poorly-financed enterprise and its stockholders.

Your committee in formulating its proposals gave serious consideration to the possible economic consequences of a policy which would force corporations to distribute every dollar of current income in order to lighten the tax burden. In that connection, you have very wisely provided for a rate structure which would encourage retention by the corporation of at least part of such current earnings. You have done this by providing that a reasonable part of undistributed earnings be taxed in the hands of the corporation at rates approximately equivalent to what the individual stockholders would be required to pay if such income were in fact distributed to them by the corporation. What you have not done, however, is to label such tax-paid income as in fact "tax paid", hence, free from further taxation in the hands of the stockholders when eventually such taxed income is distributed to them.

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

Mr. HILL. Will you state that again?

Mr. SEIDMAN. I asked the question, If such dividends are to be subjected to the individual normal and surtaxes, as you recommend, why is not the stockholder at least entitled to a credit against such tax for his pro-rata share of the tax paid by the corporation on what is left of the very same income upon which the corporation has already paid a tax?

That is the system England has employed for many years, and as a matter of equity and fairness should be pursued here if income-tax laws are not to completely topple over by the very weight of their own inequities.

It may be contended that such tax duplication is justified by the Government's fiscal needs. May I say, therefore, that if such revenue must be raised through the income tax, let it be raised by a broadening of the tax base through an increase in the normal tax, and a lowering of tax exemptions, so as to directly include a large number of our people who are today paying huge taxes in disguised form concealed in the price of the things they buy. Such a broadening of the tax base should be designed deliberately to bring home to our people the cost of our enormous Government spending which they, the people, must ultimately pay for.

Several other serious inequities in the proposed scheme of corporate taxation will have to be eliminated if corporations are to be asked to pay anything like a maximum of 73.9 of their retained net income to the Federal Government. The present Revenue Act does not permit corporations to file consolidated returns. Yet, we all know that where a business unit is conducted through two or more corporations, it is the consolidated net income that is the true net income for that business. The loss of one corporation in the group must necessarily be offset against the profit of another before true income is arrived at. For many years, our income-tax laws did in fact recognize this truth

and permitted the filing of consolidated returns by affiliated companies. But, when our Government's fiscal needs began to overshadow the element of equity and fairness in our tax laws, the consolidated return was thrown overboard. Such an inequity may be bearable under an arrangement where a corporation is subject to an income tax of from 12½ to 15 percent as is now the case, but it will certainly be intolerable under any such plan as would tax retained corporate income at rates running up as high as 73.9 percent.

The same comments could well apply to the treatment of capital losses. At present, capital gains are taxable but capital losses in excess of such gains are limited in deductibility to a $2,000 maximum. When a business is to be taxed at anything like 42½ percent of its entire net income, including capital gains, the very least to be expected is that the tax will be imposed on true net income after all legitimate business losses are deducted. Otherwise, the tax is imposed on capital, not on income, as will be plainly seen from the following illustration:

Let us take an extreme case for emphasis. Assume that for the year 1936, the Jones Corporation has a net operating income of $102,000, a capital loss of $100,000, and an actual profit of $2,000, and that it is owned by individual stockholders whose income falls in the highest surtax bracket. Its net income for Federal tax purposes is $100,000. For that reason that it has made no actual profit except for the $2,000, it distributes nothing. It pays a tax of $42,500. If it has an accumulated surplus from prior years and pays a dividend in later years, this $57,500 remaining from the fictitious $100,000 profit will be taxable to the stockholders at normal and surtax rates, such tax amounting in this case to $45,425. Thus, on an actual net income of $2,000 the corporation and the stockholders would be called upon to pay a tax of $87,925. There is, obviously, something terribly wrong about any tax system that deals with such fiction in the imposition of the tax burden.

Mr. VINSON. You gave an illustration there.

Mr. SEIDMAN. Yes, sir; this is a corporation which has a net operating income of $102,000 and a capital loss of $100,000. The actual profit on the books is $2,000. I said that, for tax purposes, all it can deduct on account of the $100,000 capital loss is $2,000; and, therefore, its taxable income is $100,000. If I am wrong about that, I would be glad to be corrected, for the reason that it has made no actual profit except $2,000, it distributes nothing, but it and its stockholders pay a tax of $87,925 according to the proposed plan.

Such a system must eventually work its own destruction. The quicker that is understood, the better for all concerned. Until this condition is remedied by law, the man of large income is bound to find a haven in tax-exempt securities, to the complete detriment of Government revenue and business enterprise.

Your committee proposes to repeal all of sections 102 and 351 of the 1934 Revenue Act as amended. Would it not appear advisable to retain subsections (d) of both of these provisions? These subsections give to the stockholders of a corporation a means of being taxed on their pro rata share of corporate income, without making it necessary for the corporation to actually distribute such income in cash or otherwise. If the stockholders, in order to ease the tax burden on the corporation and in order to conserve the corporation's working capital, are willing to pick up every dollar of corporate income in their own tax returns and pay a tax on it at normal and surtax rates, the Government should have no complaint. Under the proposed plan, that is all the Government can hope to collect in the case of our more prosperous corporations, who are in a position to distribute all of their current income and thus also escape an undistributed profits tax on their income. And in cases where the picking up of corporate income by individual stockholders is not practical, would it not seem desirable to provide that corporations distributing current earnings in the form of script, notes, or other evidences of indebtedness should be deemed under the law to have distributed their earnings, just as effectively as if they had distributed in cash, providing the stockholders currently pay their tax on such distributed income? This would at least give to the smaller and weaker corporation the same chance as the more prosperous corporation would have under the proposed law, to minimize its tax burden.

Paragraph XIV of your recommendations contemplates that the present exemption of dividends from the normal tax be eliminated. All accumulated earnings in the hands of corporations today that have been built up since 1913 are in fact "normal tax paid." Such corporations have paid the normal tax on the accumulated income over that period of time at a rate averaging perhaps 10 percent or more. In all fairness, therefore, should not such income distributed to the stockholder today be free of at least the 4 percent normal tax now in effect?

Your recommendations under paragraphs XIX and XX provide for certain so-called "relief" to corporations who are not in a position to distribute their earnings. Such "relief" is made generally to apply to corporations who, having net income for the current year, cannot distribute such income, either because of an accumulated deficit from prior years or because of some contractual obligation to retain income. In such cases, there is proposed a flat 22½-percent tax, with the proviso, however, that such tax is in no event to be greater than the tax imposed under the general provisions of the law. I would like to point out to you that these "relief" provisions may in many instances turn out, in fact, to be measures of extreme penalty. For were such corporations free to distribute their earnings and did so distribute, no tax at all upon their earnings would be imposed instead of the proposed 22½-percent tax. I believe that in the great majority of cases real relief to such corporations can be administered if their stockholders were permitted to pick up in their personal returns their pro rata share of the corporation's net income, whether distributed or not in the manner I have already suggested. In that way such corporations would receive the same treatment as those more fortunate companies who, because of ample working capital, are free to distribute, and do distribute, their income and thus minimize their undistributed profits tax or escape it entirely.

Mr. VINSON. Referring to your illustration of Jones & Co., a corporation that has a net income of $102,000 and a capital loss of $100,000—that is your illustration, is it not?

Mr. SEIDMAN. Yes, sir.

Mr. VINSON. What is you idea about the treatment? Did I understand you to say it was your idea that you would be taxed on the $102,000 under the new plan?

Mr. SEIDMAN. No, sir.

Mr. VINSON. What is you idea about the treatment of it?

Mr. SEIDMAN. Under the plan, and under the law today, which is not being changed by your plan, the taxable income of that corporation is $100,000.

Mr. VINSON. It is $102,000 according to your illustration.

Mr. SEIDMAN. No, sir; it is $102,000 less $2,000, which is the maximum that the corporation can deduct from its net income as a capital loss. Therefore, its taxable income is $100,000. As I understand your proposed plan, this corporation, in spite of the fact that it actually made on its books, and in actual fact from the business standpoint, only $2,000 of net profit that year, it must distribute $100,000 in order to escape the undistributed profits tax. If it does not distribute it—and in my illustration I said it did not distribute it because it did not make more than $2,000—it must and does pay a tax of $42,500 under your plan.

Mr. VINSON. That is where you are in error. I can very well understand why you could reach that conclusion that that might be the case, but I refer you to section 19, page 6, of the report. In paragraph 3 we have an example which is almost your case. Reading now from the subcommittee report——

> Even if no deficit exists, hardship may exist where the earned surplus at the beginning of the taxable year is not enough to meet a nondeductible loss accuring during the year. Thus suppose the accumulated earnings and profits at the beginning of the year are $1,000, the adjusted net income $100,000, but a capital net loss of $40,000 has been sustained. The earnings and profits for the year are only $60,000, making the total accumulated earnings and profits $61,000. Therefore, without relief, the corporation must pay tax on $39,000 even if it distributes $100,000, an amount equal to the entire adjusted net income.

That is your problem almost, except for an interchange of figures.

Mr. SEIDMAN. Except for a very important difference.

Mr. VINSON. What is the difference?

Mr. SEIDMAN. The difference is this, that the corporation, in my illustration, does have a surplus at the beginning of the year large enough to absorb that $98,000.

Mr. VINSON. Now, upon that point you are in error when you say that we apply under the proposed plan a maximum rate of 42½ percent on the $100,000. We would not do that in the case to which you refer, but the rate would be 22½ percent on $100,000, and the $2,000 is paying its rate in the hands of the individual stockholders.

Mr. SEIDMAN. I am very happy to be enlightened, and I hope that is correct; but in your illustration we have not sufficient surplus at the beginning of the year against which to charge the capital loss, in mine there is. That's the difference.

Mr. VINSON. That really does not enter into the picture of what we are getting at. We are taking care of that, because where the capital had been impaired by a capital loss, you really would not have a distribution of income, because if you had dividends declared out of the $100,000, it would really be a capital distribution. The treatment, under your illustration of $100,000, would be to give a 22½ percent rate.

Mr. MCCORMACK. Does that apply in the case of impaired capital?

Mr. VINSON. That is where you have impaired the capital, or where something happened during the year. In this particular illustration, you had a capital loss that occurred during the year. I would

prefer that the rate apply, not only to corporations having a capital deficit during the year, but where things occurred during the year that would make it inequitable to apply the maximum rate to the extent of the capital loss incurred.

Mr. BACHARACH. Reading section 19, what does this recommendation mean:

> It is recommended that relief be provided for the corporation which, while having an adjusted net income for the taxable year, lacks sufficient accumulated earnings and profits as of the close of the taxable year from which to distribute taxable dividends equal to the adjusted net income.

If I understood the witness correctly, they would pay from this fund against which they charge a capital loss.

Mr. VINSON. That is the general statement. Let me read it—

> It is recommended that relief be provided for the corporation which, while having an adjusted net income for the taxable year, lacks sufficient accumulated earnings and profits as of the close of the taxable year from which to distribute taxable dividends, equal to the adjusted net income.

In this particular case, your capital loss reduced the amount of profits and earnings. That is correct, but it does not reduce what we now call statutory net incomes. It falls clearly within that section.

Mr. SEIDMAN. Of course, even under your version a part of that $100,000 would be taxable as undistributed income and the balance of it would be taxable at 22½ percent.

Mr. VINSON. If your capital was $100,000, it would be subject to the 22½-percent tax rate. Anything above that would pay the income-tax rate. The income-tax rate on undistributed profits would apply.

Mr. SEIDMAN. If I understand your point, it is that this corporation would pay a minimum of the 22½ percent, or $22,500. It would pay more if any of its income is subject to the rates not affected by capital loss. Even at a $22,500 tax you will still have $77,500 ultimately in the hands of the stockholders subject to a 79-percent tax of this $100,000 fictitious income that the corporation never owned in the first place.

Mr. VINSON. The very keen witness who stands before us must admit that the tax burden under the illustration that he gave will be $22,000 less than what he thought it was when he made his statement to the committee.

Mr. SEIDMAN. I admit we are making progress.

Mr. HILL. I understand the witness to object to the charge of an income tax on the distribution of the net earnings after they have once paid the corporation tax.

Mr. SEIDMAN. Yes, sir.

Mr. HILL. You have that under the present system.

Mr. SEIDMAN. As I understand it, you are now proposing a system which will be equitable, or which the President said would be equitably arranged, so that no profits will be taxed twice. Corporations today pay 12½ percent to 15 percent of their incomes. That is purely the normal tax, and the businessman has looked upon that as a tax for doing business as a corporation. But you now propose to be equitable to all business profits and tax them alike. Therefore, once the business profits are taxed at the rate at which they would be taxed in the hands of the stockholder, at both normal and surtax rates, that should certainly be sufficient. You now propose a tax on the corporation at such

a rate as would apply to the individual stockholder as if he received his share of the corporate profit. Why then tax the individual again when he receives what is left after you have once taxed the same profits of the corporation at the individual normal and surtax rates?

Mr. HILL. I think you are adding too much territory there. Under the plan proposed by the subcommittee, up to a reasonable amount for reserves, of say 30 percent, we do not tax them any more than they pay now under the present corporation tax plan. A corporation may, according to the amount that it holds back from distribution, regulate the amount of tax it may pay on earnings and profits in one year. There is no difference in principle between taxing that which is to be distributed under no circumstances to the stockholders and the plan under which we are operating at the present time.

Mr. SEIDMAN. It is for that reason I wanted to read what the President said in that regard, and with your permission, I will read just one sentence:

> Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, 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.

I think when you tax corporate income as if it were distributed to the beneficial owners at normal surtax rates, that income should be tax free to the stockholder thereafter.

Mr. HILL. That has never been the plan. It is not the plan of the President, nor any plan of the committee, where the corporation tax involves also the individual, or where it also involves the distribution of corporate earnings. That has never been the plan, and we are not advocating that. That is not in the recommendation made by the Department in that respect.

Mr. SEIDMAN. I do not wish to argue the point at all. I am here at your mercy.

The CHAIRMAN. We thank you for your appearance.

The next witness is Mr. Melville F. Weston, of Boston, Mass.

STATEMENT OF MELVILLE F. WESTON, REPRESENTING RAYMOND-WHITCOMB, INC., 30 FEDERAL STREET, BOSTON, MASS.

The CHAIRMAN. Mr. Weston, give your name, address, and the capacity in which you appear before the committee.

Mr. WESTON. Mr. Chairman, my name is Melville F. Weston, and I am a director of Raymond-Whitcomb, Inc., a Boston corporation engaged in the business of travel tours and cruises.

This business is semispeculative in its nature. In other words, it has perhaps a little more than the normal ups and downs under the most favorable conditions. It is, as business in this country goes, a small business. We may earn or lose $20,000 to $200,000 in a given year. It is not the kind of business that usually comes down to Washington and hopes to affect the course of legislation, and the very fact that we have come here at all is perhaps some indication of the sincerity of our apprehensions.

Due to a dividend policy in the years preceding 1930 and 1931, which was, as it turned out, too liberal, we came into those years with inadequate funds to carry us through a period of severe depression in our particular line of business, and went thoroughly and completely "bust", from any balance sheet point of view. In order to stay in business, we induced our creditors, spread all over the world, and holding about $500,000 of our obligations, to accept an issue of prior preferred stock, and to that issue we annexed some very drastic sinking-fund provisions, providing that the first $30,000 of our income in any year should be exempt from the sinking-fund requirements; that of the next $70,000 in any year we should set apart 20 percent, and that of all the excess above $100,000 we should set apart 40 percent.

Mr. VINSON. I beg your pardon. Will you state again what you have agreed to?

Mr. WESTON. $30,000 of our income is exempt from sinking-fund requirements; the next $70,000 is subject to a 20-percent deduction for sinking-fund requirements; and after $100,000 has been reached we have contracted to set apart 40 percent of any excess income.

Now, when I computed what this meant in connection with the figures that were given out in the newspapers, I found that if we were to estimate an income of $150,000 for a given year our sinking fund requirements alone would be $34,000 and I figured what, as a director, I would consider to be the maximum that, as a matter of sound business, we ought, knowing our hazards, to distribute in dividends in any year, and I could not figure that it could possibly come over $77,000, which would leave us, from the point of view of this law, $73,000 of undistributed income. In other words, we would be in the class of 40 to 50 percent retained, unless some allowance were made for our sinking fund. If allowance were made for our sinking fund, we would be in the class of 20 to 30 percent retained.

I therefore looked into the various saving clauses which the committee's report contains, and I found that there were several analogies to our situation, but no provision expressly covering us. I found, for example, that we were practically in the situation described in paragraph 1 of article XIX, except that we had merged our past earned deficit, so to speak, in our capital structure by replacing it with stock issued to creditors. I found that we had, in effect, contracted not to use a large part of our income to pay dividends, which resembles article XX, but our obligation is not put in that form expressly. I found that since we were to use our sinking fund moneys to repurchase and retire this creditors' stock as fast as we could, we were close to the analogy of article XVIII relating to liquidating dividends; but once more we were within the spirit rather than the letter of the committee's recommendation.

Listening to what was said to the last speaker, I came to appreciate that many of these things have been drawn to express principles, and that possibly what I am referring to is a problem of draftsmanship; but I would still consider it worth while to appear before the committee to make it apparent how important to us, and how important to many other companies similarly situated, that problem of draftsmanship is. I may say, in passing, that while I appear for but a single company, two other companies for which we are attorneys have been through reorganizations that have resulted in somewhat parallel situations; one situation having drastic sinking-fund provisions attached to an issue of bonds, the other company being about to incur some very drastic obligations to the R. F. C. with respect to how it will use its income. Possibly those cases are all governed in principle by these reservations.

Now, the difference in tax to us, if by any chance we were not protected on our sinking-fund requirements, is very large; because unless we allow our business judgment as to what we should pay out to be overridden by the compulsion of some law such as this law might turn out to be, I am very sure we would not pay out in dividends more than the amount that I have mentioned, and if our tax were to be computed on the 40 to 50 percent retained basis, our tax would be $52,500, while if an allowance were made for our sinking-fund requirements our tax would be $22,500. In other words, this single item would more than double our tax.

Now, there is a provision here which I frankly cannot interpret, which makes the undistributed net income the adjusted net income minus not only taxable dividends paid but also the tax itself. I have no doubt that the figures that I have given you would be subject to modification by reason of that provision. Just what it would mean in dollars and cents is more, frankly, than I can compute on the basis of that skeleton outline of the principle of the law; but the proportions, I judge, would remain substantially unchanged.

Mr. McCORMACK. Mr. Weston, you are appearing principally in the sense of seeking information, I take it, in addition to giving us the benefit of your own thoughts?

Mr. WESTON. We are, frankly, sir, opposed to the underlying principle of the law, but are most vitally concerned with this problem—whether, in any law which may be drawn or may be passed, adequate provision is made for companies which have been compelled in the course of the past few years to commit themselves to very drastic sinking fund provisions.

Mr. McCORMACK. The company that you represent has an agreement with reference to the preferred stockholders whereby 30 percent of the net earnings are exempt from the sinking fund?

Mr. WESTON. The first $30,000.

Mr. McCORMACK. The first $30,000. Then the next $70,000——

Mr. WESTON. The next $70,000 is subject to 20 percent for the sinking fund.

Mr. McCORMACK. 20 percent of that?

Mr. WESTON. 20 percent of that goes to the sinking fund. That will be $14,000.

Mr. McCORMACK. So 80 percent of the $70,000 is exempt, and somewhere between 80 and 85 percent of the first $100,000 is exempt?

Mr. WESTON. That is right.

Mr. McCORMACK. And after the first $100,000 it is 40 percent in excess of that?

Mr. WESTON. Yes, sir. So the next $100,000 would pay $40,000 to the sinking fund, or the next $50,000 would pay $20,000.

Mr. McCORMACK. That would be $55,000 or $60,000 going into the sinking fund?

Mr. WESTON. That is right, sir.

Mr. McCORMACK. It is my understanding that we have that particularly in mind—to protect such contracts; and that probably would come under the 22½-percent tax. That is my understanding of it.

Mr. VINSON. When was the contract entered into?

Mr. WESTON. In 1931.

Mr. McCORMACK. Furthermore, if you had impaired capital—of course I did know what the law in Massachusetts was, but it is not very fresh in my memory, concerning dividends from impaired capital—then there is a provision applying the 22½-percent rate to that.

Mr. WESTON. You see, technically we have no impaired capital, for the reason that we translated our debts into this prior preferred stock, and in order to show an honest balance sheet, we attributed to all our stock, which has no par value,a very low nominal capitalization. We have really got your first situation under article XIX in our company, but we have translated it into a form to which you make no reference, where it is a part of our capital structure instead of being a bookkeeping deficit.

Mr. VINSON. Don't you think paragraph XX meets your situation? The mere fact that you arrive at the amount that must go into the sinking fund through graduation does not take it out of that class, does it?

Mr. WESTON. Paragraph XX refers in its express language to an agreement not to pay out as dividends a stipulated portion of our income.

Mr. VINSON. That is what you have done.

Mr. WESTON. Of course, as a consequence of what we have promised, we cannot pay it out as dividends; that is true.

Mr. VINSON. Then, if your contract could be so construed as to mean, as it does from your statement, that you cannot pay out these particular percentages in dividends, how can you have any doubt but what paragraph XX catches you?

Mr. WESTON. For one reason, because of my doubt but what paragraph XVIII might, if enlarged, by implication to about the same degree; because paragraph XVIII refers to a deduction for any part of liquidating dividends, and so on.

Mr. VINSON. Where do you get a liquidating dividend out of your case?

Mr. WESTON. Because with our sinking fund we buy the stock to be retired. Technically it is not a retirement of the stock, but first purchasing the stock and getting it into the Treasury and then canceling it is, for most practical purposes, the equivalent of a retirement.

Mr. VINSON. Before you get enough money to buy your preferred stock—dealing solely with the amount of money that goes into your sinking fund and forgetting any subsequent transaction—don't you think paragraph XX meets that situation? And, for the purpose of the record, I would like for that to be included at this point, because I think it will be clarifying to others who will follow you.

The CHAIRMAN. Without objection, it will be included in the record.

(Paragraph XX of the report is as follows:)

CONTRACTS NOT TO PAY DIVIDENDS

"It is recommended 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 22½ percent on the part of the adjusted net income which equals the net earnings and profits which it is prohibited by the contract from using for the payment of dividends, and on the remainder of the adjusted net income, if any, shall be taxed at the rates applicable under the appropriate schedule applicable to an adjusted net income equal to such remainder. It

should be provided this provision shall in no case operate to increase the tax that would be payable without its application."

Mr. VINSON. I would like to read a couple of lines from that, if the gentleman from Massachusetts will permit.

It is headed: "Contracts not to pay dividends."

"It is recommended 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"—

Now, certainly you ought to fall under either one of them.

Mr. BACHARACH. Will the gentleman from Kentucky yield?

Mr. VINSON. I yield.

Mr. BACHARACH. With regard to your reference to the provision about paying dividends, nothing has been stated to the effect that they have not paid dividends.

Mr. VINSON. No; but it is this question of having made a bona fide contract to put the money into a sinking fund. Consequently, that implies to me that there shall be no dividends declared out of that portion. The language is:

"Made a bonafide contract * * * not to pay out as dividends a stipulated portion of its earnings and profits for the taxable year."

It just seems to me that the principle underlying paragraph XX, which is to avoid the imposition of the maximum rate where there have been bona fide contracts made prior to January 1, 1936, and which prevent the payment of earnings and profits in dividends, meets your situation.

Mr. BACHARACH. I would like to have the witness state that they have not paid dividends. That covers your point.

Mr. MCCORMACK. I think what we are trying to do is to see if the gentleman who is appearing as a witness can have a clearer idea as to what these general recommendations might mean. I think it is a very important thing for the benefit of witnesses like the last witness, who had a misunderstanding in his mind, and for this gentleman, who used the word "apprehension," to show that he was seeking information.

It seems to me, Mr. Weston, that with reference to the amount which you have to set aside for sinking-fund purposes under contract, whether it was 22½ percent or not, under the 22½ percent recommendation the balance would be subject to the general purposes of the proposal.

Mr. WESTON. Let me state, then, two propositions in general reply to the observations of members of the committee.

There is a close resemblance between my case and the language of article XX, but as a matter of draftsmanship or legal interpretation, in my opinion, a good many more words would have to be used to bring our case within the scope of article XX in any law which might be written. I am quite sure that these words alone, if we sought the benefit of them, would not be given in the first instance so wide an interpretation by the Government.

Mr. HILL. Mr. Weston, I understand your fears go to the proposition, first, whether you come under the recommendation no. XX, and, secondly, under recommendation no. XVIII?

Mr. WESTON. Yes, sir.

Mr. HILL. Now, as has been stated here by Mr. Vinson, if you have a bona fide contract that compels you to pay into a sinking fund a certain portion of your earnings and profits for any current year, then that same obligation would necessarily prevent you from paying out that portion as dividends, would it not?

Mr. WESTON. There is no question of it, sir.

Mr. HILL. So you come squarely under recommendation no. XX on that. Now, then, having held it back in the sinking fund at a 22½-percent rate, as provided in this recommendation, you are fearful that when you retire your preferred stock you will not get credit for it as a liquidated dividend?

Mr. WESTON. I had not thought, sir, to hitch the two propositions together and drive them tandem in just that way.

Mr. HILL. That is what you stated a while ago.

Mr. WESTON. I was a little uncertain whether we might not come in the alternative under one or the other, and fall between the two stools, so to speak.

Mr. HILL. They are both for your protection.

Mr. WESTON. Yes, sir.

Mr. HILL. I will say this: They are both in your favor; and under recommendation XVIII, if you held back to build up a sinking fund, and by means of that sinking fund retire this preferred stock out of your earnings and profits, you will get a credit for it as for distribution, and will not have to pay any tax on it when you distribute it.

Mr. WESTON. I have no doubt that if the principle which I am advocating meets with the approval of the committee, in the course of drafting the bill it can be taken care of, and that the language which will be required to take care of it will be a great deal more directly apposite to our case than the language of recommendation no. XX.

Mr. HILL. We have anticipated your dilemma in advance and have provided for it in these recommendations.

Mr. WESTON. The next contention which I might take the liberty of making in connection with article XX is this: That in point of fact many corporations situated like mine, if they were to distribute—if they were in a position to distribute—these moneys to their stockholders, would not be conferring on their stockholders incomes which would be taxable at anything resembling 22½ percent, and it seems to me a little drastic that for the privilege of earning the money to pay off our past debts we should be taxed more than one-fifth of every dollar we earn. And, as I say, in the case of my own company in particular, which has numerically a large proportion of stockholders of very moderate means, the taxes which they would actually have had to pay had they received this money themselves directly would never have approached the rate of 22½ percent.

Mr. VINSON. Will the gentleman admit that if he put 30 percent into a sinking fund, which is nontaxable in the hands of the individual distributees— taxable in the hands of the corporation—and he makes a distribution of 70 percent, he will be paying less taxes than he is paying now?

Mr. WESTON. I will go further than that. I will say that we will also accomplish within 5 years the destruction of the business.

Mr. VINSON. Now let us see what your dividend rate has been in the past 5 years, since you bring that up. What has been the percentage of dividend declared by your corporation during the last 5 years?

Mr. WESTON. We have declared no dividends in the past 5 years.

Mr. VINSON. Have you made any net income?

Mr. WESTON. The predecessor corporation lost several hundred thousand——

Mr. VINSON. I am not asking you about your predecessor corporation. I am talking about this one.

Mr. WESTON. I have to use it, sir, to make 5 years.

Mr. VINSON. Well, tell me about that—when the one comes in and the other one goes out.

Mr. WESTON. There was 1931, 1932, 1933, 1934, 1935—no; you are quite right, sir. You are perfectly right.

We lost money in the fiscal year beginning in 1931. We made perhaps $20,000 in the next fiscal year. We may have doubled that in the next one.

Mr. VINSON. You mean about the same amount of money?

Mr. WESTON. The fiscal year ending August 31, 1932, resulted in a loss of $12,000.

The fiscal year ended August 1933 resulted in an operating profit, before taxes, of $17,000.

The fiscal year ended August 1934 resulted in an operating profit, before taxes, of $31,000.

The fiscal year ended 1935 resulted in an operating profit, after taxes, of $77,000.

Mr. VINSON. After taxes? Part of the time you have it before taxes and part of the time after taxes.

Mr. WESTON. I have to give you the figures in that form, sir, because that is the form in which I have them. For 1935 we would have to pay about 17 percent in taxes altogether; so you have to add that on.

Mr. VINSON. Let us take your last year. How much did you put into the sinking fund in the fiscal year that ended August 1, 1935?

Mr. WESTON. $7,150.

Mr. VINSON. How much did you declare in dividends?

Mr. WESTON. None.

Mr. VINSON. How much tax did you pay?

Mr. WESTON. To the Federal Government alone?

Mr. VINSON. Of course I do not know how you have these figures.

Mr. WESTON. We paid to the Federal Government alone, I should say on these figures, $13,000 or $14,000.

Mr. VINSON. Of course it is very difficult for us to follow your income, because you give 1 year with taxes and 1 year without. I am not criticizing you; I am just saying that it is a difficult matter for us to follow through.

Mr. WESTON. I can assure you that, apart from the fairly large amount involved in 1935, the differences would be negligible.

Mr. VINSON. In the fiscal year ending August 1, 1934, how much did you put into the sinking fund?

Mr. WESTON. None.

Mr. VINSON. How about 1933?

Mr. WESTON. None. Those were all covered by the $30,000 of exempt income.

In other words, sir, so long as we do not make substantial earnings, the question that I bring up is not material; but we hope to make, and we must make, in order to have a profitable business on the basis upon which we are organized, $100,000, $150,000, or even $200,000 a year.

Mr. VINSON. As you say, under the 5-year period which we have been discussing, for all practical purposes there is no basis for fear, so far as that 5-year period is concerned. It is a question of fear as to the situation that might obtain in the future.

Mr. WESTON. Yes. That 5 years represents our return from almost a hopeless situation to the present prospect of substantial, reasonable earnings, and it is that present prospect with respect to which I am concerned when confronted with this bill.

Mr. VINSON. At any time during the 5-year period have you had a capital deficit?

Mr. WESTON. A capital deficit?

Mr. VINSON. Yes.

Mr. WESTON. Not as I set the corporation structure up because, in order to avoid that, and in order to show a clean, though small balance, we put all of our stock into nopar-value stock, with but a very small capital value assigned to it, thereby eliminating the burden of a deficit of the predecessor company.

As I say, if we had left this company as it stood in 1931 we would have had no place for this prior preferred stock which I am talking about, as a capital deficit, amounting to approximately half a million dollars, but this prior preferred stock stands in lieu of it today.

Mr. VINSON. On that capital deficit the proposed 22½-percent rate applies?

Mr. WESTON. Yes.

Mr. TREADWAY. Let me make this inquiry, in general. You have studied this subcommittee report to the full committee, which is now under consideration

Mr. WESTON. I have attempted to, sir.

Mr. TREADWAY. You are talking particularly about subsections 18 and 20?

Mr. WESTON. Yes, and I would say as to subsection 19 also, if we had not changed our situation.

Mr. TREADWAY. Without going into the technical details, is your object in being here, representing the Raymond Whitcomb Co. for the purpose of placing the business situation of that company before the committee with a view of hoping that subsections 18, 19, and 20 will not be put into law?

Mr. WESTON. No; I hope the committee will realize what it means to this corporation among other like corporations to have incurred a drastic obligation with respect to a sinking fund, and that you will give us some sort of credit for a sinking fund before you impose upon us very drastic rates for reserving from our stockholders moneys which we could not distribute to them anyway. I hope that in drafting a bill that will be given the most careful recognition.

Personally, I believe any income so retained should not be taxed at the rate of 22½ percent, but at the lowest permissible rate.

And lastly, I am opposed to the principle of the tax schedules themselves.

Mr. TREADWAY. You mean by the tax schedules——

Mr. WESTON. The principles of the law.

Mr. TREADWAY. The principle of taxing surplus.

Mr. WESTON. Quite right.

Mr. TREADWAY. But further than that, this section 20, as I understand it, applies to setting aside an obligation that a company like yours may have entered into to secure fresh capital. You have obligated yourselves not to pay dividends either on new stock or old until your surplus has accumulated sufficiently to take care of a sinking fund that represents new capital; is that right?

Mr. WESTON. We do not put it in quite that form.

In order to let our creditors let us stay in business we induce them to accept our prior preferred stock. There is a contractual provision whereby we agree to take a certain percentage of our income on a sliding scale and put it in a sinking fund and immediately repurchase or retire preferred stock with it.

Mr. TREADWAY. Then section 20, if put into law, would prevent your carrying out that obligation?

Mr. WESTON. No.

Mr. TREADWAY. Or seriously affect that obligation?

Mr. WESTON. No, I do not believe section 20 would prevent our doing that. But I do not think section 20 would quite protect us in carrying it out, and unless the language is broad enough, it will tax us 22½ percent for the purpose of letting us get some money.

Mr. TREADWAY. You are familiar with business conditions in Boston, outside of your connection with this one large concern?

Mr. WESTON. On a moderate scale.

Mr. TREADWAY. Would you be disposed to testify that these provisions of sections 18, 19, and 20 would seriously handicap a good many business people, either in Boston, or in other similar business centers?

Mr. WESTON. I would rather put it in this way, that the provisions of sections 18, 19, and 20 do not go far enough to prevent this bill from handicapping business operations of the entire country.

Mr. BACHARACH. Mr. Treadway asked you a question, and I think Mr. Vinson asked you a question on the same line, which I think you did not answer.

Is there any provision whereby you are prohibited from paying dividends on your common stock?

Mr. WESTON. Not at all.

Mr. BACHARACH. That question was asked you, and you did not answer it.

Mr. WESTON. I am sorry; I did not realize that I had not answered it.

Mr. BACHARACH. As I understand it, your real objection to this proposition is that you believe that a 15-percent tax is high enough for your business, and you do not believe that a person who gets a dividend should have to pay the normal tax.

Mr. WESTON. As applied to our business, speaking with respect to the money we have to hold back in the sinking fund, we would be taxed 22½ percent, a much heavier burden than would be put on the stockholders if they got the money.

Mr. BACHARACH. If the stockholders should get the money they would have to pay the normal tax, with a corporation tax increase from 15 to 22½ percent, and that is the reason you are here objecting?

Mr. WESTON. That is in part the reason. I think the reason strikes even more fundamentally than that, and it goes to the principle of the law itself.

The CHAIRMAN. You expressed some apprehension that possibly a corporation engaged in business might be handicapped by the operation of the bill which might be based upon this report we have before us.

Did you ever hear of a tax bill being drawn concerning which some taxpayer did not say that his business would be handicapped by the payment of the tax proposed? It would not be possible to draw a tax bill concerning which some taxpayer would not say that his business would be handicapped if such a tax were enacted. Do you think it would be possible to enact a tax bill without that objection being made?

Mr. WESTON. No; I cannot imagine your drawing a tax law to raise taxes and revenue but what somebody would be hit by it.

The CHAIRMAN. Somebody would be affected.

Mr. WESTON. I agree with you perfectly on that.

The CHAIRMAN. I believe the witness has expressed the hope that our draftsmen would be very careful in the preparation of the bill. If you have any doubt about that, I wish to remove from your mind any doubt as to the efficiency and special qualifications of our drafting experts to put into proper legislative and parliamentary form any principle that we may desire to be carried out in the form of a tax bill. If you have any doubts about that, I wish to remove those doubts now.

Mr. TREADWAY. Mr. Chairman, I want to corroborate what our distinguished chairman has stated in reference to the capacity and ability of the drafting service. Possibly you have not the same confidence in them that we have. But as to those who will instruct the drafting service as to what to draft, that is where the difficulty comes, in my judgment.

Mr. WESTON. Quite right.

Mr. TREADWAY. You are facing the men who will instruct the drafting service. After the drafting service gets its instructions, then everything is safe. It is just a question as to the judgment of those who will be obliged to shape the tax measure.

Further than that, in connection with what you said in answer to the chairman's remark about somebody always being hit by a tax bill, would you favor some form of a tax bill to meet extravagances, or would you prefer to cut off the extravagances?

Mr. VINSON. A point of order, Mr. Chairman. I think we have had enough politics here.

Mr. TREADWAY. Evidently there is only one side that will be considered.

Mr. VINSON. There is only one side.

Mr. COOPER. I want to ask the witness a question about the bill. If we have to raise the amount of revenue suggested in the President's message, it would require an increase of the present existing corporation rates to about 25½ percent. Would you favor that in preference to the proposed plan?

Mr. WESTON. That requires me for the moment to accept an assumption with which I am not in accord, but so far as I can go along with that assumption I would say this. I would favor a measure for increasing the corporation tax rate to any provably sound rate on the present basis over this method of figuring corporation taxes.

As to whether such a rate could be proved at 25 percent, if it be assumed that the revenue is needed, I do not know. That is the nearest I can come to answering your question.

Mr. COOPER. With all due respect, you have not said anything that touches my question. If you will be kind enough to answer it, I will appreciate it.

Mr. WESTON. Your question is what?

Mr. COOPER. My question is this: In order to raise the amount of revenue we have been requested to raise, it would require an increase of the present system of the corporation rate to 25½ percent. You understand that, I assume.

Now, then, would you prefer that to the plan suggested here?

Mr. WESTON. I do not know, because I have not figured out how we would get around this plan, if it should be put into effect.

Mr. COOPER. You have not figured how it would affect you?

Mr. WESTON. I have not figured out how far one could go by way of paying out the earnings of my company except as to the sinking fund requirement, to have the stockholders put it in a pool for refinancing. I think if you make the rates drastic enough, with a fairly small group of stockholders, they would put it back in a refinancing pool. But I have not figured it on a comparative basis of 25 percent.

Mr. MCCORMACK. Assuming that there is a $200,000 net income, the amount in the sinking fund would be about $55,000?

Mr. WESTON. Yes.

Mr. MCCORMACK. With a 30-percent reserve, do you realize that you would pay less taxes than you pay now?

Mr. WESTON. I have heard it stated, but I do not think I realize it yet.

Mr. MCCORMACK. I mean, assuming that we have frankly conveyed to you will be the bill as it is reported, assuming that the contractual relationship you have in mind permits all of it being deducted and subject to the flat rate which has been proposed, of 22½ percent, that would leave $145,000.

Mr. WESTON. Yes.

Mr. MCCORMACK. Subject to the general purposes of the proposal. With 30-percent surplus retained, do you realize that the corporation tax would be less than the corporation tax now would be on $200,000 statutory net income?

Mr. WESTON. Let me assume that that is so, whether I realize it or not. We cannot, in my judgment, conform to an abstract conception of an average corporation requiring a 30-percent reserved. We can lose all of the last year's income in a single cruise, if we considered general conditions, the state of the country, and what have you.

If practical experience has taught us anything it is that we are a type of prince and pauper business that cannot be assimilated easily and put into a procrustean bed on a 30-percent reserve. We might possibly make money under your bill, if you could change it, but frankly I do not see how we can do it.

Mr. COOPER. Of course, it will not be overlooked that if you do not make any money you do not have to pay any taxes.

Mr. WESTON. That has been one of our solaces in the past 10 years.

Mr. COOPER. If you do make any money, you are willing, are you not, to pay a fair share of the taxes, commensurate with your earnings?

Mr. WESTON. I take it I have been addressing myself wholly and only to the question of what is fair.

Mr. LAMNECK. I have not been here all the afternoon, and I was not here when you began your statement. What sort of business are you in?

Mr. WESTON. Travel, tours, and cruises.

Mr. LAMNECK. Did you ever have any other business experience?

Mr. WESTON. Personally, while I am the attorney and clerk of the company, I am a lawyer, but we represent quite a considerable number of corporate enterprises.

Mr. LAMNECK. I was very much interested in the question Mr. Cooper, of Tennessee, asked you with reference to your opinion as to increasing the present corporation tax from what it is to a higher rate in order to raise some of this revenue.

You understand, I suppose, that under the proposed bill it is intended to repeal the present tax law that applies to dividends from corporations distributed to individuals.

Mr. WESTON. Yes, sir.

Mr. LAMNECK. Under that provision we raise, or it is intended to raise, about $263,000,000.

Mr. VINSON. We do not propose to repeal that law.

Mr. LAMNECK. As to the normal taxes.

Mr. VINSON. We do not repeal the part that taxes the surtax brackets.

Mr. LAMNECK. The part that repeals the present normal tax rate on dividends to stockholders from corporations. That raises $263,000,000, I am told.

Let me ask you this question: Assuming that an amendment is offered to this proposal which would incorporate that same provision, would you favor an increase in the present corporation tax to raise a sufficient amount above the $263,000,000, to raise the revenue that is proposed to be raised under this bill, if it was not an extreme hardship or did not threaten the corporate structure of your business, or individuals in such business?

Mr. WESTON. I would not say to put it all there. That is one place where you can pick up some more, I think, without putting the country out of business. But I would not favor that bearing the whole load.

Mr. LAMNECK. You would favor a tax on corporations that would permit you, after you paid the tax, to run your own business, would you not?

Mr. WESTON. Yes, if there were any business left to run.

Mr. LAMNECK. In other words, you would favor a tax that, after you found what you were going to have left, you could do with it what you wanted to do; you could pay dividends or keep it in surplus, or build up a reserve, perhaps, for some sort of improvement.

I am speaking generally of the tax law and the effect upon industry generally. You would favor some sort of a tax that would permit you to do with your surplus what your judgment dictated you should do.

Mr. WESTON. I think, unquestionably, the effect on business is better, proportionately, as business judgments are not swerved from their normal and reasonable course by excessive taxes.

Mr. LAMNECK. I assume the witness thinks I am unfriendly to his attitude, but I want to assure him in the beginning that I am not.

I have before me a statement of a business concern that in 1928 made $3,371,739.48. In 1929 they made $3,715,975.46. In 1930 they made $2,624,974.62. In 1931 they lost—you know, people in business lose money, too; you know that, do you not? Do you or not?

Mr. WESTON. I think I do.

Mr. LAMNECK. In 1931 they lost $4,495,796.96. In 1932 they lost $3,847,638.40. In 1933 they lost $2,815,959.89. In 1934 they lost $121,485.88. In 1935 they made a profit for the first time in 5 years, of $670,620.12.

As a general proposition, as a businessman, do you think any tax bill should be passed that would penalize the replacing of this capital in any business?

Mr. WESTON. No, sir. Now I have no question as to whether you are friendly or not, because that comes squarely and directly to the thing that I had personally in mind to say as my last word on this bill.

I have in mind two corporations, both clients of our office, both employers of thousands of men, having incomes that run into the millions. One is a corporation that is almost perfectly described by what you have just said. It is a business that depends very largely on fluctuations in inventory to determine whether its income for a given year is large or small, or nonexistent.

The other corporation is a public utility, easily able to refinance at any time, able to sell its securities, having no need to retain large reserves, having a fairly level income, in a far more secure position, year in and year out, than the first corporation, which is like the one you have described.

Which of those two companies needs kindly treatment from the taxing laws? Which company would get kindly treatment from this taxing law? The public utility company, which can easily refinance, which has adequate depreciation and plant reserves, and which has a fairly level income, which can afford to pay out almost all of its income to its stockholders, can almost cut this tax, in my judgment, under the proposed measure, despite the fact that due to the stable character of the enterprise, its position as an artificial monopoly, and the minimized hazards of its business, it is in a much stronger position in the community than the other company.

The other company is just practically alive today, after the last 10 years of operation, by virtue of having to make nearly as much money as it lost, when coupled to what it had to pay in income tax.

That company, under a bill like this, would not be alive today because it could not be financed. It is a company employing thousands of men.

That leads me to say one other thing, and that is this: There is something in the recognition of a corporation as a business entity. There is a purpose which a company or a business serves besides padding the pockets of its stockholders.

The company of which I speak has not done anything for its stockholders for years. It supports labor through wages, and it supports the municipality through taxes, and it provides the people with goods, through the making of goods. If you go to taxing a business of that type in a way that makes no allowance for bad years, that ignores the principle of a former law allowing a carry-over from year to year, with a net loss, when you ignore the net-loss provision and then slap on it a provision like this, in my judgment, you will cause damage sooner or later to the business structure.

Mr. LAMNECK. This company I referred to, fortunately, still has a little surplus. If it had been a company that had no surplus today, under this provision of the tax bill, if it wanted to rebuild its losses, we would tax them about 42½ percent, if they kept all of their earnings.

On the other hand, if the company had an aggregate capital we would tax them 22½ percent.

Mr. TREADWAY. Is your company a member of the Boston Chamber of Commerce?

Mr. WESTON. Are you referring to Raymond Whitcomb & Co.?

Mr. TREADWAY. Yes.

Mr. WESTON. I do not know.

Mr. TREADWAY. Is the Boston Chamber of Commerce represented here by the business of Boston and vicinity?

Mr. WESTON. It ought to be.

Mr. TREADWAY. I am asking you the question.

Mr. WESTON. So far as I know, it is a very adequate cross section of the community.

Mr. TREADWAY. Would you be disposed to be favorably inclined toward their opinion on tax measures, after due study?

Mr. WESTON. I should think so.

Mr. TREADWAY. Would you subscribe to this sentiment, taken from the publication of the Boston Chamber of Commerce?

> In the very year in which the tax for unemployment insurance goes into effect, another tax is devised which is calculated to destroy the best form of unemployment insurance that any country can have; that is, the existence of sufficient surplus in many enterprises to keep business going when times are bad.

Do you agree with that?

Mr. WESTON. I do; I agree with it perfectly.

Mr. VINSON. You referred to a provision of law as to a carry-over provision for 2 years, I believe.

Mr. WESTON. We used to have that, yes.

Mr. VINSON. When was that repealed? I believe it was in the 1934 act, was it not?

Mr. WESTON. I should say a little before that, but I may be wrong.

Mr. VINSON. In order to get the date correct, it was the 1934 act.

Now, do you recall the Senate hearings that were held, that brought about the repeal of the 2-year carry-over provision?

Mr. WESTON. No, sir. This is the first time I ever had the temerity to appear in Washington on a tax bill.

Mr. VINSON. I asked did you hear about the Senate hearings that preceded that?

Mr. WESTON. No, sir; I am not familiar with that at all.

Mr. VINSON. You do not recall that that 2-year carry-over provision was stricken from our tax law after it had been developed that Kuhn-Loeb & Co., Morgan & Co., and scores and scores of other large financial institutions had not paid any taxes for 1929, 1930, and 1931, or substantially no taxes?

Mr. WESTON. I do not recall.

Mr. VINSON. Do you recall anyone in the Senate or the House that has the termerity, using your own term, to oppose the elimination of that 2-year carry-over provision?

Mr. WESTON. As I said before, sir, I am so totally unfamiliar with the history of that particular legislative measure that I cannot answer your question.

Mr. VINSON. Speaking for the House, I can say to you that in the committee, the elimination of the 2-year carry-over provision was adopted without a dissenting vote; and as I recall it, no one on the House floor raised a voice against the elimination of that 2-year carry-over provision.

Now; if I understood my good friend from Massachusetts, Mr. McCormack, a moment ago, did you propound an assume case of $200,000 income a year to the witness?

Mr. MCCORMACK. Applying to this case; yes.

Mr. VINSON. Now, as I understood it, substantially $60,000 would go to provide or to take care of your sinking fund.

Mr. WESTON. $54,000, to be exact.

Mr. VINSON. If it is $54,000, to be exact, you said something about declaring out the rest of that money in dividends to stockholders. You thought possibly you might save some money. Did I understand you correctly?

Mr. WESTON. I started out with a case of $150,000, and I said if we had $150,000 of income, I thought the maximum we ought to pay as a matter of sound business, in dividends, would be around $75,000. If you assume $200,000, I would be disposed to raise that somewhat.

Mr. VINSON. How much would you raise it?

Mr. WESTON. Not beyond $100,000, in any event, from my knowledge of the business. I will say this frankly, but for the pressure of this bill, if enacted, that much would not go out under our existing conditions, because our working capital has not yet been built back to the point where we can swing major enterprises with a free mind.

Mr. VINSON. With your $54,000 going to sinking fund, at 22½ percent, your tax would be $12,150.

Mr. WESTON. On that money.

Mr. VINSON. On that money?

Mr. WESTON. Yes.

Mr. VINSON. As against the $200,000 assumed, the present tax would be over $30,000; is not that correct?

Mr. WESTON. That sounds right to me.

Mr. VINSON. With $200,000; $100,000 distribution, $54,000 sinking fund, there would be left $46,000 to be taxed under the new proposal. That would fall in the class of corporations that would be affected by the rate between 20 and 30 percent. That rate is 15 percent of the adjusted net income up to 30 percent.

Taking the maximum of 15 percent—and it would not be that, because it would be down in the 23-percent class, but figuring it at 15 percent—that would be about $22,000, roughly, because you would have $54,000 that would come out of your base. So you would have $146,000, and whatever that percentage would be—say, 12½ percent, which I think would be substantially correct, of $146,000—it would be substantially $20,000. That, plus your $12,150, would make the amount approximately $30,000, so that your tax would be $2,000 more than it is at the present time.

Now, you have got your capital-stock tax, whatever that would figure, and you have got any excess profits tax that might have to be paid. For the purpose of the record I will figure out exactly what the tax computation is, because I think that would be clarifying to some degree.

Mr. CROWTHER. Mr. Chairman, may I say to the gentleman from Kentucky, if I remember correctly, the net loss provision was changed in 1932 to 1 year.

Mr. VINSON. I beg the gentleman's pardon. I happened to offer the amendment in the full committee in 1932 and the House Ways and Means Committee adopted it. It was put in and stricken out in the Senate and was left out of the 1932 bill.

Instead of the 1934 tax bill, it was the N. R. A. bill that the provision was put in. That was 1933. I offered the same amendment in the committee. It was adopted without a dissenting voice, passed the House without a protest or objection, and I do not recall any in the Senate. It was the N. R. A. bill that it finally went into instead of the 1934 act.

Mr. WESTON. It went into effect January 1, 1933.

Mr. COOPER. Mr. Watson, you said something a moment ago about corporations or industries continuing to operate very largely in the interest of the community, or something to that effect.

Mr. WESTON. I do not think that is what motivates them; it is the result, very frequently.

Mr. COOPER. How is that?

Mr. WESTON. I do not think that is their motive, but it is the result very frequently.

Mr. COOPER. Well, it is not always true, is it? They do not always take into consideration the question of employment and the effect on the community, do they?

Mr. WESTON. No; they do not.

Mr. COOPER. The fact is, it is the exception that they do that, is it not?

Mr. WESTON. Speaking purely of the decisions of heads of businesses to remain in business, I suppose that would be the exception rather than the rule. Circumstances force them to go on and they do go on, and while they go on, they do the community a good deal of good, if nobody kills them off.

The consideration is one to be addressed more, I think, to this honorable body, for example, than to the businessman.

Mr. COOPER. Well, you rather emphasized that point.

Mr. WESTON. Yes.

Mr. COOPER. In the course of your statement, and it attracted my attention.

Mr. WESTON. I emphasized it because the results are so clear and so plain; when you see a company which has not had a cent for its stockholders in 10 years but has actually during the period given support to thousands and thousands of employees, you can see that it has served a useful purpose in the community, whether it meant to or not.

Mr. COOPER. And some of them give first consideration to their stockholders in the payment of dividends even to the disadvantage of the employees, do they not?

Mr. WESTON. That is right; there are all kinds.

Mr. COOPER. Are you familiar with the statement that is purported to have been made by the president of the A. T. & T. Co. about their practice along that line during the depression?

Mr. WESTON. No; I am not familiar with his statement.

Mr. COOPER. I am informed that the president of the A. T. & T. Co. testified before the Federal Communications Commission that his company discharged 600,000 employees during the depression, yet during that period they continued to pay dividends to their stockholders. So certainly that is a rather striking illustration of the fact that in some instances at least consideration goes to the payment of dividends and the considerations of the employees and the unemployment problem of the country get last consideration, if any at all.

Mr. WESTON. That is just the kind of a concern that, as I mentioned in my illustration, this bill would hit least hard, because of the level basis of their income.

Mr. COOPER. Of course, there might be a difference of opinion on that.

Now, in the illustration given by the gentleman from Ohio to you, and with which you agreed, about the corporation that had gone along for several years and made money and then for several years failed to make any—what about the situation of an individual that has that experience?

Mr. WESTON. Will you make the question a little more direct, sir?

Mr. COOPER. All right, sir. Instead of the corporation that went along for several years making large net profits and then finally running into several years where it sustained losses, suppose that had been an individual or a partnership that had had that experience; had gone along several years making large profits, and then several years following they failed to make any profits. That individual and that partnership, of course, would have paid income tax on that statutory net income during those profitable years, would they not?

Mr. WESTON. Yes, sir.

Mr. COOPER. And then when it came along hard times and they sustained losses, what consideration would they have received?

Mr. WESTON. None.

Mr. COOPER. Then why are the corporations of this country entitled to any different consideration than other people engaged in business?

Mr. WESTON. Because any individual who considers the corporate structure better adapted to their type of business, more suitable to level out the fluctuations of income, can incorporate.

Mr. COOPER. And is not one reason for that the past system in reference to taxes?

Mr. WESTON. Why, certainly, and it is a fair one.

Mr. COOPER. And you want that continued?

Mr. WESTON. I do.

Mr. COOPER. Although it is not in keeping with the principle of fairness to individuals or partnerships engaged in the same line of business?

Mr. WESTON. That I deny.

Mr. COOPER. Well, in what respect is not that so?

Mr. WESTON. I deny it for this reason, that as a matter of observing for some number of years how business men go about setting up their enterprises, with an eye to all the advantages of doing business in one form or another, a business to which the corporate form is better suited, not only can incorporate, but always has and always will incorporate, if the advantage remains.

Now, you cannot talk about discrimination between a partnership and a corporation, when the members of the partnership have a right to incorporate any time they want to. If they are not incorporated, it is because they sense no discrimination or else they have some other advantage in some other direction that outweighs it.

Mr. COOPER. And in free America they ought to have the right to conduct their business as a partnership, if they want to, without their competitor having a definite and a distinct advantage over them as a corporation, so far as taxes are concerned.

Mr. WESTON. Is that a question?

Mr. COOPER. Do you agree to that?

Mr. WESTON. I do not, as stated; I disagree.

The CHAIRMAN. Are you a stockholder in this company that you represent, or do you just represent them as an attorney?

Mr. WESTON. I only hold a qualifying share of stock, sir.

The CHAIRMAN. Who is the president of the company?

Mr. WESTON. Gilbert E. Fuller.

The CHAIRMAN. Do you mind telling us the salary he draws, and bonus, if any, per annum?

Mr. WESTON. My feeling is that I ought not to, without instructions from Mr. Fuller.

The CHAIRMAN. I understand that it is a matter of record that Gilbert E. Fuller, the president of your company, for the fiscal year 1935, drew a salary and bonus to the amount of $30,442.71. Would you care to verify that, or have you any knowledge on the subject, or do you prefer not to disclose it, if you have?

Mr. WESTON. I do not think I could verify the exact figure, but I think it is close enough to be right.

The CHAIRMAN. I understand that at the same time they paid no dividends.

Mr. WESTON. That is right.

The CHAIRMAN. How can they pay salaries of that kind, of that size, and not pay dividends? A company that can afford to pay salaries that large apparently considers that the stockholders are not in very great need of dividends. Do you think a tax law that permits exorbitant salaries like that, and then passes on to surplus certain amounts in order to escape higher taxes, should not be improved?

Mr. WESTON. Do you want me to discuss the entire question as to whether that was a fair and proper compensation under all of the circumstances?

The CHAIRMAN. No, I just want you to answer my question. Every question that has been asked you has caused you to make a great long stump speech. We do not want any speeches.

Mr. WESTON. How can I answer that question if——

The CHAIRMAN. It takes only a few words to answer that question. I will say that in all courtesy.

Mr. WESTON. I do not agree that the salary was unjust under all the circumstances and since I do not agree that it was unjust, I do not see how——

The CHAIRMAN. You do not think salaries of that kind are unjust, when no dividends are paid?

Mr. WESTON. Mr. Fuller used to get from the old company a salary of $50,000 a year, and he was worth it. After the company went under, in 1931, he drew for 3 years a salary of $3,000 a year, despite the fact that he had to pay more than that in interest on his indebtedness to keep going and avoid bankruptcy.

The CHAIRMAN. What has that to do with it?

Mr. WESTON. It has this to do with it, Mr. Chairman——

The CHAIRMAN. What a man has to pay in interest on his personal indebtedness has nothing to do with the salary that he ought to draw from a company for which he is working. Salaries should be based on the value of his services rather than on his own personal indebtedness.

Mr. WESTON. It has this to do with it, that he had all the incentive in the world to get a larger salary, if he chose to, but he did not.

The CHAIRMAN. But that is not the reason that he should have a large salary, because he has a certain amount of personal indebtedness. The salary should be commensurate with the services rendered to the company.

Mr. WESTON. I voted for it, as a director.

The CHAIRMAN. You would not take the position that a man's personal indebtedness should be a basis for fixing his salary, would you?

Mr. WESTON. No.

The CHAIRMAN. Then why go into that at all?

Mr. VINSON. Will the gentleman yeild?

The CHAIRMAN. I yield to the gentleman.

Mr. VINSON. This amount of $30,000 plus in salaries was paid out of what we call the statutory net income, or was it deducted before you arrived at your statutory net income of $77,000?

Mr. WESTON. Deducted.

Mr. VINSON. What was your net income, including salaries to the president and other salaried officers?

Mr. MCCORMACK. You mean what was the gross income?

Mr. VINSON. No; if he took that you get into another field. You take the net income of $77,000. Now what other salaries were paid last year?

Mr. WESTON. I could not give you that figure, because I do not know it. But the nearest I can come to giving you a fair answer is that it would be quite substantial because this company is practically a personal service company. It has no plant; it has no inventory.

Mr. VINSON. You say it has no plant?

Mr. WESTON. It has no plant.

Mr. VINSON. It does not count anything off for depreciation, then?

Mr. WESTON. No.

Mr. VINSON. Depletion or obsolescence?

Mr. WESTON. No; none of them.

Mr. VINSON. Or any things of that kind?

Mr. WESTON. It is a personal service company.

Mr. VINSON. What would you estimate the other salaries aggregated, other than that paid to the president?

Mr. WESTON. I would not dare to estimate, sir. I might be too far afield. I can simply say that it is the major expense than advertising and rent.

Mr. VINSON. How many stockholders does this company have of record?

Mr. WESTON. Sixty or seventy, I should say offhand.

Mr. VINSON. Are most of them connected with the operation of the concern?

Mr. WESTION. Perhaps as many as half.

Mr. VINSON. Then it does not make much difference to the half whether they get paid salaries or whether you have dividend declarations, does it?

Mr. WESTON. Not to the half.

Mr. VINSON. But to the other half, it makes quite a bit of difference, does it not?

Mr. WESTON. Yes.

Mr. VINSON. And they have not received a dividend in 5 years?

Mr. WESTON. That is right.

Mr. VINSON. And during this time I take it that these 30 out of the 60, this half, have been getting their salaries right along?

Mr. WESTON. Right.

Mr. VINSON. Possibly somewhat fat in fat years and in some years somewhat lean salaries?

Mr. WESTON. The salaries have been so lean to date that it would almost drive a horse to drink.

Mr. VINSON. And when you get a chance to make a good bite in 1935, salaries go up and dividends to those who do not have a salaried connection with the corporation remain unpaid. That is a correct statement?

Mr. WESTON. Yes.

Mr. VINSON. That is all?

The CHAIRMAN. Do you think you can justify salaries of that size?

Mr. WESTON. Yes, sir.

The CHAIRMAN. Without any dividends to the stockholders who may need some income from their investment?

Mr. WESTON. Yes, sir.

The CHAIRMAN. You think you can?

Mr. WESTON. Yes, sir.

Mr. CROWTHER. I hope we are not losing sight of the fact that that salary and all the salaries to that half of the stockholders who are officers in the company were taxed by the Federal Government. That $30,000 salary is subject to taxation.

I saw a criticism the other day of a $200,000 salary. But when we got to figure it out, the man only received $97,000 of it, and $103,000 was paid in taxes, or something in that neighborhood.

The CHAIRMAN. But the poor stockholder got nothing.

Mr. CROWTHER. But we do not want to lose sight of the fact that the Government gets a lot of money in taxes out of these salaries. They are not altogether free and clear, they are not all velvet.

The CHAIRMAN. They are as free and clear as they can make them.

Mr. CROWTHER. Not under our present rates. If you had that salary of $30,000, you would just grind your teeth when you were writing your check to pay the taxes on it.

The CHAIRMAN. I would not expect to draw that much of a salary.

Mr. CROWTHER. Well, you or I might not be worth it.

Mr. HILL. It is one way of getting out of the corporation tax.

Mr. WESTON. Lest there be some misapprehension on the subject of——

The CHAIRMAN. According to your idea of what a corporation tax should be, the earnings could all go to large salaries, and then to surplus, to get out of paying a large tax, and the poor stockholder would get nothing, no matter how badly he needed it. That would be possible.

Mr. FULLER. Mr. Chairman, I suggest that we have taken an undue amount of time to be informed by this witness, and I suggest that he be excused.

The CHAIRMAN. If there are no further questions, thank you, Mr. Weston.

Mr. WESTON. I am grateful to you for your consideration.

The CHAIRMAN. The next witness is Hon. William S. Bennet, representing the National Lumber Manufacturers Association.

Mr. Bennet, will you please state your name and the capacity in which you appear, for the record?

STATEMENT OF HON. WILLIAM S. BENNET, REPRESENTING THE NATIONAL LUMBER MANUFACTURERS ASSOCIATION, NEW YORK CITY

Mr. BENNET. Mr. Chairman and gentlemen: My name is William S. Bennet; my address is 25 Broadway, New York City, and I represent the National Lumber Manufacturers Association.

The CHAIRMAN. You have indicated that you would like to be recognized for 15 minutes?

Mr. BENNET. Yes.

The CHAIRMAN. And you prefer not to be interrupted until you complete your main statement?

Mr. BENNET. Thank you.

The CHAIRMAN. Without objection, the gentleman will be permitted to proceed 15 minutes without interruption.

Mr. BENNET. I appear in opposition to recommendation 13 of the subcommittee, reading as follows:

DIVIDENDS OUT OF PRE-MARCH 1, 1913, SURPLUS

It is recommended that dividends paid out of earnings and profits accrued before March 1, 1913, or out of increase in value accrued before March 1, 1913, be fully taxable when distributed.

Our viewpoint is precisely the same as that presented by Commissioner Helvering this morning, on page 9 of his statement, where he said in part:

The corporate form of business organization is, nevertheless, desired by numerous small and medium sized enterprises for reasons of convenience, flexibility and the like. Discrimination in taxation against the corporate form of business enterprise, as well as discrimination in its favor, would be removed by the present proposal.

And we agree that on page 6 the Commissioner stated the equitable situation when he said:

The earnings withheld by corporations add no less to the wealth of the shareholders than the earnings distributed in dividends; * * *

In other words, that the earnings made by corporations belong and add to the wealth of the shareholders, and therefore what corporations had acquired prior to March 1, 1913, were their property and, as a matter of fact, that is the holding or has been the holding of Congress up to this good date.

This precise question has been before the Congress eight times. The original enactment in the 1916 act has been reenacted seven times without substantial change.

In just one moment I can state the situation as it occurred originally.

The first act, of course, as we all know, was the 1913 act. Necessarily, it was not perfect, although it was a very good act.

Then the Commissioner of Internal Revenue thought that he could collect—and he was correct about it—a tax on dividends of corporations no matter whether the earnings had been before the 1st of March 1913, or subsequent to the 1st of March 1913. And no one can criticize the Commissioner of Internal Revenue for taking that view and attempting successfully to execute the law and collecting the tax until the law was changed.

He was subsequently upheld by the court of appeals. But as soon as he raised the question, various parties——

Mr. HILL. Did it stop at the court of appeals?

Mr. BENNET. I meant to say the Supreme Court of the United States. The court of appeals is the highest court in my State and I sometimes make that mistake.

The Supreme Court of the United States in the case of *Lynch* v. *Hornsby* upheld him. As a matter of fact, the court of appeals held against the Commissioner and the district court held against the Commissioner, but the Supreme Court reversed them, in the case of *Lynch* v. *Hornsby* (247 U. S. 339).

But before the case got up there, the lumbermen, the southern lumbermen, who were most immediately affected, saw the injustice of the situation. They brought the matter to the attention of the Ways and Means Committee of the House. The chairman at that time was Mr. Kitchin, and in the 1916 act, the second act, Mr. Kitchin, a personal friend of many of us, now dead, a man who had a very high sense of justice and right, wrote into the law this provision:

Provided That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association or insurance company out of its earnings or profits accrued since March 1, 1913.

That is another way of saying that nothing that a man had, or a corporation had, prior to the 1st of March 1913 could be taxed; that that was capital. And that principle has remained in the statute ever since. It is in there now. It is subdivision (b) of section 115 of the 1934 act. And it has been upheld by every chairman of this committee, with the possible exception of William R. Green, who, I think, never went on record; Mr. Underwood in the Senate; Mr. Kitchen, whom I have mentioned; Mr. Fordney, Mr. Collier, and Mr. Crisp, who was acting chairman.

Back there in 1913 and 1916 the men who construed the sixteenth amendment were not only good men but good lawyers, and they construed their responsibilities and rights under the statutes, and Senator Overman in the Senate stated this in substance. What a man had, whether he was an individual or a partnership or corporation,

on March 1, 1913, is free of tax. There is no discrimination against the Government or against the owner or anything else. All are treated alike.

And that is the view that the Congress has continually maintained since.

Now, in that case of *Lynch* v. *Hornsby*, they had a case before them involving $171, where the tax was only 1 percent, and they drew a narrow, technical distinction which Commissioner Helvering does not draw, and we agree with the Commissioner, between the corporate entity and the individual corporate owners. As a matter of fact, taking all the stockholders together, they own the property of the corporation and this is what would happen if this recommendation 13 were adopted.

Let us take a place down there in the South. And this has happened time and time again. Let us say that there are four people or four organizations that would own timber that they bought in the nineties when a lot of timber was being bought in the South.

This first one here is an individual, the next one is a partnership, the next one is a corporation, and this last one is a corporation.

Each of them paid $100,000 and on the 1st of March 1913 the value of that timber of each of them had increased 100 percent and was worth $200,000.

Well, the individual cuts out. He puts his money in his pocket. You cannot touch him. The Constitution protects him. It is his property. He owned it on the 1st of March 1913. It is not income. It cannot be taxed.

Next comes the partnership. You cannot tax them. They put their money in their pocket. They owned it on the 1st of March 1913. And I might say that the reason I use the date March 1, 1913, is because when they passed the Income Tax Act of 1913, in October 1913, they put the effective date back to March 1, 1913. The sixteenth amendment had become a part of the Constitution in February 1913, and the Supreme Court of the United States said they had a right to date it back to March 1, 1913, giving the dividing line between capital, which was everything that everybody owned up to that date, and capital income after that date.

Now, here comes along a corporation that owns a third tract that has a 100-percent increase in value to March 1, 1913. Well, they say, we have cut it, and we have this $200,000; we will liquidate, and we will go out of business, and that is what they do. Then, you cannot make them pay a dollar of taxes. That is decided in the case of *Lynch* v. *Turrish*, in the 247 United States Reports, page 221. Now, here is a fourth crowd—and I am glad to say for the credit of the human race that there are a good many of these men in the South and Middle West, and to a certain extent in the West, but not so much there yet because it is a new industry. They are coming along behind. When they go in and cut the timber out, sell and quit, which they could do without paying a dollar of tax, they would have some more ghost towns left. Therefore, they have remained in business. They remained in business, and, therefore, Congress protected them. They were protected under an amendment put on the tax bill by Mr. Kitchin 20 years ago. Now, what would happen if that provision were changed? This would happen: There would be a certain number of them that could liquidate completely. They could liquidate

with no tax imposing a discrimination on them. There is a lot of this property owned by railroads and banks and long-time organizations like those, and they will never distribute.

The Union Pacific, the Southern Pacific, the Pennsylvania, and all of those railroads have had a greater proportionate increase in the value of their property than has been the case with some of the lumber and mining companies. But, as I have said, they will not distribute. They will never be affected, but the lumber company and the mining company, when the time comes that all the timber is gone, must liquidate. Ordinarily they have got to distribute. It is just a case with them where to be taxed would mean a rank discrimination against what I have referred to as a corporate form of business, but, in reality, it would be a discrimination against a fragment of the corporate form of business. It would be just a few kinds of corporations, and not all of them. It would be against those particular corporations that could not completely liquidate. Now, here is what they are doing, and what they want to continue to do, and what some will have to do: They ask that the money that was there before March 1, 1913, be protected. They buy new timber, new ore, and they conduct new business. They have been conducting that business, or most of them have, right straight through, since 1929, at a loss; but they have been keeping towns going, paying wages, and buying goods. They have been helping to keep the country on an even keel.

Now it is proposed by this recommendation no. 13 that, because of that newer construction, in that one case, back in 1917, that this handful of corporations be subjected to this tax. There is not much money involved in it. I do not know how much there is, but the subcommittee, in 1934, said it would be $6,000,000 annually. I have always considered that figure as rather illusory because of what the tax would amount to on what the company had, or the amount of dividends that were made. However, I think we can take it safely that it would not be over $6,000,000. Therefore, the amount is not a large one, but the principle involved is important. It is the principle of fairness, equity, and justice that is involved. If this plan were adopted, it would be a bad principle, introducing a discrimination where a discrimination does not now exist. It is another thing that lawyers recognize as what you might call the rule of property. This has been a rule applied to these corporations for 20 years, and if it were changed now, it would be another form of discrimination. It would be a discrimination against the fair-minded, broad, liberal, and progressive and considerate people, and in favor of those who in past years, or those standing strictly on their rights, have closed their oil claims out, and cut their timber out, taking advantage of the situation as it was and of the Constitution as it is. They have taken advantage of the situation, and completely liquidated and gone out of business.

That is about all I have to say, gentlemen. These arguments have been made for 20 years before six, seven, or eight different Congresses. They have appealed to each Congress, and they have appealed to the leaders in thought on the subject of taxation in both the Senate and the House. That principle was written into the law by one of the ablest men, one of the most just and high-minded men in Congress, Claude Kitchin. It was the unanimous view of Congress and of the conferees of the Senate and the House. In my judgment, that provi-

sion ought to continue to remain in the law, as it has remained for 20 years.

Mr. VINSON. Upon three separate occasions, the House has not taken the same view that you have so ably expressed here.

Mr. BENNET. At least three.

Mr. VINSON. In each instance, the Senate has taken the view that has been so splendidly presented by you, and the law has been left unchanged after conferences were held on the bills.

Now, you refer to the Lynch case.

As I understand it the decision of the Supreme Court on the question of value as of March 1, 1913, they held it as being capital. Is that correct?

Mr. BENNET. The *Lynch* v. *Turrish* case held that; yes, sir.

Mr. VINSON. Yet, the Supreme Court in a later decision departed somewhat from the theory that the value of March 1, 1913, was really capital, it being referred to as profits and as tax-exempt income. Did they not say that in the *Canfield case*?

Mr. BENNET. No, sir; I am quite familiar with the *Canfield case*, and I do not so construe it.

Mr. VINSON. It has been some time since I have seen that decision, but my thought or my recollection is that they referred to it in this *Canfield case* as tax-exempt income. Regardless of that, and I will check on it for the purpose of future consideration, what the values of March 1, 1913, actually are is the capital cost of the property plus a write-up as of March 1, 1913.

Mr. BENNET. What write-up?

Mr. VINSON. A write-up in value.

Mr. BENNET. Not in the way I use that term personally. Here is what it is, as expressed in the statute—the cost, plus any additions from earnings, and plus any accumulation of increase in the value of the property.

Mr. VINSON. In other words, the March 1, 1913, value is the cost, plus the earnings and plus the added value of the property.

Mr. BENNET. Yes, sir.

Mr. VINSON. Now, do you have any income tax paid upon earnings prior to March 1, 1913?

Mr. BENNET. Nobody does.

Mr. VINSON. Under the philosophy of this bill, as I understand it, it is contemplated to tax corporation dividends which now bear surtax rates at the normal rates.

Mr. BENNET. You are talking about your recommendation, entirely apart from values of March 1, 1913.

Mr. VINSON. Yes; or earnings that have accumulated since March 1, 1913, that are declared in dividends, and are actually earned. They are to bear the normal rate. Do you understand that to be the thought behind the plan?

Mr. BENNET. I read that in the recommendation.

Mr. VINSON. I would like for you to develop your thought as to the reason for subjecting the actually earned income since March 1, 1913, to the normal rate and exempt your increment or your added value to the property acquired prior to March 1, 1913.

Mr. BENNET. Of course, the recommendation which I am asked to explain is not my recommendation. It is the recommendation of the subcommittee, and, if I recall correctly in relation to this particular

recommendation, the subcommittee gives no reason. It simply says after the adoption of the recommendation that tax will be levied.

Mr. VINSON. Let us take that recommendation and apply it: The normal rate on earnings actually obtained subsequent to March 1, 1913, in relation to earnings obtained by increased book value prior to March 1, 1913, and I think I will come right back to the four little illustrations: Here is an individual you cannot tax, here is a partnership you cannot tax, and here is a corporation completely liquidated that you cannot tax. There are three classes of stockholders constituting the exemptions. Here is the bank, here is the railroad, and here is the large holder, and you cannot tax him.

Mr. BENNET. The illustration you make in regard to the four corporations deals with the corporation that acquired its holdings prior to March 1, 1913.

Mr. VINSON. What I would like for you to develop is this: If we are going to tax at the normal rate and as dividends the surpluses that have accumulated subsequent to March 1, 1913, as proposed in this plan, what can you say about not taxing surplus where it was accumulated prior to March 1, 1913, and particularly where a large portion of it is written-up value?

Mr. BENNET. It would be just what Commissioner Helvering said this morning, that the property became the property of those stockholders before March 1, 1913, and that it is not income in any sense.

Mr. VINSON. What about the property earnings that were acquired by the corporation subsequent to March 1, 1913, but prior to the effective date of the act?

Mr. BENNET. A lumber company, and anybody else, is taxable on earnings since March 1, 1913.

Mr. VINSON. But you will not for a split second say that Congress has not the power to subject that surplus before March 1, 1913, to the tax. You will not say that Congress has not the power today to subject that surplus to the normal tax.

Mr. BENNET. I may have the temerity to say that to a certain extent. I say that Congress, under the *Lynch* v. *Hornsby* decision, by the Supreme Court of the United States, in 247 United States report, page 339, would have that power. Therefore, the presumption is that they have the right to do exactly what recommendation no. 13 proposes. I do not undertake to say, however, that under changed circumstances the Supreme Court would in a case coming up where the tax might run to 60 or 70 percent on the stockholder would make the same decision that they made when the tax on the stockholder was 1 percent.

Mr. VINSON. Can you give us any reason why we should tax surplus accumulations since March 1, 1913, and not those accumulated prior to March 1, 1913?

Mr. BENNET. Yes, sir; I will give Senator Overton's reason, Senator Underwood's reason, and Claude Kitchin's reason, and also Senator Simmons' reason.

Mr. VINSON. And I can give you the action of the House on three different occasions, and would put that over against the reasons that prevailed in the Senate. I do not think that is a good argument. I think you should get down to the point and tell me what the distinction is, or why we should tax surpluses that have accumulated since March 1, 1913, as actual earnings, and not tax surplus or accumulated profits prior to March 1, 1913.

Mr. BENNET. If you will permit me, I will tell it the other way around, but I will answer the question exactly. The reason is that any tax on accumulations prior to March 1, 1913, would be, in the first place, a discrimination against the corporate form of business; and, second, it would be a discrimination against certain corporations. In the third place, it would be a discrimination against stockholders in the same line of business in different companies, because one set of companies can distribute their property that they held prior to March 1, 1913, tax free, under constitutional protection, and I think you should not take advantage or make brutal use of a technicality which possibly would permit you to tax those few stockholders in a few corporations.

Another reason that appeals to me as a citizen, with an interest in the country, is that you ought not to single out for discriminatory action the stockholders who, knowing that by a chance in the form of their corporate organization, and by quitting and doing everything of that sort, they could save themselves from any change of being taxed, have, nevertheless, put their money back in Texas, Louisiana, Alabama, Mississippi, North and South Carolina, Georgia, Wisconsin, and Minnesota, in order to keep the industry alive. I know of a case down in Mississippi where a sawmill was burned down, and the timber acreage was nearly cut out. Those men went in and bought timber at high prices, as much as $15 per thousand feet for stumpage. They did that because they have 50 or 60 men with them, and by doing that they could give them 4 years' more work. They are the kind of men that this action would penalize, and for what purpose? It would be to get some fraction of $6,000,000 a year. From the Government standpoint, it is not a 5-cent cigar.

Mr. CROWTHER. It would be chicken feed.

Mr. BENNET. Yes, sir.

Mr. VINSON. I grant you that it does not compare with the $100,000,000 values that are tax exempt. I know of an instance of marked-up values amounting to three or four hundred million dollars, that had not been paid out in dividends, and it was tax exempt.

Mr. BENNET. I imagine that was the copper company. If they are still in business, this may not affect them, because the corporation may dissolve and distribute the money tax free.

Mr. VINSON. But if we had passed the law initially, that would not have occurred. The fact that it has not been passed does not change the correctness of the policy behind such an act.

Mr. BENNET. You could not pass a law that would compel liquidation, because under the Lynch decision, in 221 U. S. Report——

Mr. VINSON (interposing). Would that compel liquidation?

Mr. BENNET. Yes, sir; it would compel liquidation in the case of the lumber companies.

Mr. VINSON. I am not speaking of the *Lynch case*, but I am speaking of the *Copper Co. case*.

Mr. BENNET. I do not know about the *Copper Co. case*.

Mr. VINSON. My recollection is that went over a period of years.

Mr. BENNET. I do not know that case, but I do know this, that if they are still in business, they would be compelled to liquidate and distribute their assets tax free. Your recommendation no. 13 would not affect them, but it would affect the little man or the small stockholders, it would affect the broad-minded people who have been

putting up good money in order to maintain the country during the depression.

Mr. VINSON. I though you said that most of these holdings were in the hands of railroad companies and banks.

Mr. BENNET. I said the holdings of the railroads and the banks would not be affected, because they will not be distributed.

Mr. VINSON. I take it that some of the railroad holdings are in the form of public-land grants.

Mr. BENNET. No, sir.

Mr. VINSON. How about the western roads, or the Northern Pacific?

Mr. BENNET. I am not so familiar with the West, but if you will take the Pennsylvania Railroad, it has a lot of that property that it owned before March 1, 1913, but they will never distribute it. If you take the Bank of Manhattan, which was established by Aaron Burr, in 1789, they have a lot of this property, but they will never distribute it.

Mr. VINSON. Why do you say they will not distribute it? I can see no reason why they would not distribute it.

Mr. BENNET. I may be wrong, but I have lived to be 65 years old, and I have never seen any of that character of corporation distribute any such property.

Mr. VINSON. We have only had the income tax for 23 years.

Mr. BENNET. The only time they ever distribute is when they go into the hands of a receiver, as they sometimes do.

Mr. VINSON. Do they not sell any of that property?

Mr. BENNET. A railroad company never sells its right-of-way.

Mr. VINSON. I am speaking of timberlands. I have in mind some railroads that have certain public-land grants that are splendidly timbered, and sometimes I have known of a lawsuit going through the courts for the sale or disposition of those holdings. You would have this problem of determining what was proper to be credited to them for capital and what would be proper to be credited to them as surplus.

Mr. BENNET. Here is what would happen in the case of those concerns: The profits would go against general losses. They would be active. You will not catch banks and railroads, but you will just catch the natural resources corporation like a mine or a lumber company. In some way or other they will have to go out and distribute. This amendment will simply catch people who since 1925 have been active and alive, keeping towns going and keeping business alive. You would simply be discriminating against the stockholders of those few companies for the sake of the few paltry dollars that would be collected. It was stated to be about $6,000,000 as the maximum, and the minimum would be nothing. It would be going absolutely contrary to the spirit of the proper interpretation of the pleas or proposals made this morning by my old associate, the Commissioner of Internal Revenue.

Mr. BUCK. You referred to banks and railroads as holders of timber properties. Where they hold them as permanent assets or investments, the railroads and banks would not under any circumstances part with the holdings that they acquired prior to March 1, 1913.

Mr. BENNET. Yes, sir; that is true.

Mr. CROWTHER. I do not know anything about the legal technicalities, but it looks like a breach of good faith.

Mr. BENNET. That is what it is.

Mr. MCCORMACK. As I understand from your statement, the provisions of this law were applied years ago to all corporations, but that this proposal would apply only to natural resource corporations.

Mr. BENNET. To the extent that they would have to pay the tax, yes.

Mr. MCCORMACK. Your theory is that having acquired these accumulations, and the accumulations having occurred under the provisions of the law, any change should take into consideration those equities.

Mr. BENNET. Yes, sir.

Mr. MCCORMACK. Do you not think that the same thing should apply to the freezing of surpluses which the corporations have drawn out of their statutory net income?

Mr. BENNET. They recommend the repeal of that section.

Mr. MCCORMACK. Corporations between 1913 and today have paid corporation income taxes, have they not?

Mr. BENNET. Yes.

Mr. MCCORMACK. And they have set aside certain reserves out of their net statutory income after paying corporation income taxes. In that they were not imposing upon the Government, and it would be double taxation to tax it in the hands of individuals when it is distributed. The reserves set aside have been set aside after paying corporation income taxes.

Mr. BENNET. Yes, sir.

Mr. MCCORMACK. Why should we freeze the law now and not make the normal tax applicable to dividends declared in the future out of past surpluses?

Mr. BENNET. I think that question illustrates my wisdom in calling attention to the fact that the subcommittee gave no reason for it.

Mr. MCCORMACK. Your idea of protection, and in support of retaining the present law, would apply equally to freezing this particular law to the time of its passage, so far as repealing the normal tax on dividends declared in the past is concerned.

Mr. BENNET. You want me to make a frank and candid answer.

Mr. MCCORMACK. I would expect that.

Mr. BENNET. My frank and candid answer to that would be this, that these equities are in such a position that I think the equities in favor of the stockholders of natural-resource corporations are far greater even than the equities which your question assumes.

The CHAIRMAN. We thank you for your presentation.

(Thereupon, the committee adjourned to meet tomorrow, Tuesday, Mar. 31, 1936, at 10 a. m.)

March 30, 1936

4 pm

MEETING OF REPRESENTATIVES OF CANADIAN LIQUOR DISTILLERS AND STATE DEPARTMENT WITH TREASURY OFFICIALS.
Present: From Canada: Mr.Wrong of Canadian Legation; Mr.Jacobs and Mr. Phillips of Seagram's; Mr. Lash, Hiram Walker; Col. Ralton and Mr. Forsythe of Consolidated Distilleries; From the State Department; Mr. Hickerson, Mr. Hackworth and Judge Moore; from the Treasury: Mr. Taylor, Mr. Frank and Mr. Graves, Mrs. Klotz.

Col. Forsythe: We have never been told there was any claim against us, as a matter of fact. Of course, that is one of the difficulties we have had in the beginning.

Mr. Hickerson: I wondered if the gentlemen would be able to say who the defendants are to be.

Mr. Frank: I don't think that would be proper at this time, except to say the expected defendants are not confined to Canada.

Judge Moore: We haven't any French or British or Ethiopians or Italians yet; only have had Canadians. I was just wondering whether you are in position to say who the defendants are. Then you will know how many of the defendants are represented here. It might be simple to say whether these people are defendants.

Mr. Frank: I don't think any of these gentlemen here are interlopers.

Mr. Hickerson: Is Canadian Distilled Alcohol the same

as Consolidated Distilleries?

Col. Ralston: No; Consolidated Distilleries is a subsidiary.

Mr. Frank: I suppose to simplify it, we might ask how many of the distilling companies are represented here and how many are not represented. I don't know.

Mr. Phillips: As a matter of fact there are one -- two-- three.

Mr. Lash: I think it would be rather nice to know who the proposed defendants are, because you have said nothing to us yet -- nothing that tells us of any claims of any kind nor do we know of any specification of any kind.

Judge Moore: Mr. Lash asserts that his hands are clean!

Mr. Lash: We have had no notification of any claim.

Mr. Frank: Wasn't there a visit made up to your office, Mr. Lash?

Mr. Lash: A man by the name of Joe Green and some man from Detroit, whose name I don't remember, came up and spoke to the Walker people and suggested that the books of Hiram Walker be thrown open to his investigation. He had no credentials, other than we were willing to believe he was whom he said he was, and we explained that not even the shareholders would be permitted to go through the books. That's the situation. He didn't tell us anything at all, except he wanted

to look through the books.

Mr. Frank: I thought he did a lot more than that, but it was so long ago.

Mr. Lash: It's over a year ago. Yes; I had an interview with yourself, last summer, and you told me that you were sorry that you could not even tell me there was anybody to whom I could speak.

Mr. Frank: That was true.

Mr. Lash: That there was no person who seemed to know anything about this. Now, I would like to know something about it.

Mr. Phillips: You know, we saw Mr. Graves and yourself and some other gentleman sometime last July and we stated that we were informed that the Treasury contemplated making claims against our company and we stated we would be glad to sit around the table to determine the nature and merits and we were then told that we might be expected to be called upon in 30 days for further conference. We then communicated with you and the day before the expiring of the 30 days you stated you were not yet ready to consult or communicate with us, but we might expect to hear from you, and not being pursued, we have become the pursuer and we are here to find out the nature of the claim and what it is all about. I think it is a fair request, as a result of this proposed legislation

and all the circumstances surrounding it, as a clarification of the issue.

Mr. Frank: I thought the nature of the claim against the people you represent was fully gone into with Mr. Davis and Mr. Harding, so you had no doubt as to the nature of the case although I did gather you had considerable doubt as to the merits.

Mr. Phillips: The latter part is correct, but as to the first part I am not here to speak for the gentlemen who are not here, but I do not think the nature of the claim has been formally submitted to us, but if it has, I ask for it again. I must say we are somewhat at sea, not entirely so because the legislation is indicative.

Mr. Frank: This is taking a different slant from what we expected. I think it is sufficient to say that there are large claims for evasion of customs duties and customs revenues, not to speak of internal revenue due on liquor brought into this country prior to 1933, for which we have proof and the law, in our opinion, to hold your companies responsible. You people know what you did probably better than we do -- what your clients did -- and I don't think it would be worth while to go into a long outline of the nature of our investigation and the nature of our proof. I think that is sufficient.

Col. Forsythe: I don't know what Mr. Phillips thinks, but I should point out that the company I represent -- Mr. Gordon became the President in 1934 or sometime around that time, and the Board of Directors is entirely different in composition from what it was in the years prior to the repeal of prohibition; absolutely different people, and the shareholders to some extent have changed, but to say to the President of my company that you will ask practical assurances, without his particular knowledge of what went on before, that certainly would be drawing an inference altogether unfounded, but when people talk about practical assurances, the most practical thing you have to know is what is the amount involved? If I were asked for practical assurance of what (?) amount, my attitude might be entirely different and I do think if there is a claim against my company it certainly has not been established as to the nature or amount. If there is a claim asserted by your Department against my company and some practical means of avoiding litigation about it is projected, I think the first thing I have to know is that (a) there is a claim; (2) the amount of the claim, and (3) I think in common politeness, to say the least, in view of the situation of the new Board I am entitled to have some particulars of it, but certainly the essential thing must be to have some knowledge of the amount.

Mr. Graves: Do you have any objection to this legislation?

Col. Forsythe: I certainly do.

Mr. Graves: What's your reason?

Col. Forsythe: First, the legislation is bad legislation. As affecting my company, I don't think any legislation should be passed that gives one individual power by merely taking action against me for something I know nothing about, to prevent me from doing business in another country which he can do under the legislation. I think it is preposterous.

Mr. Graves: I was thinking of what you would say about your right to be informed as to the amount of the claim and the nature of the claim. Under the legislation you would be so advised.

Col. Forsythe: Yes; but the thing I object to, so far as my right to do business with the United States is concerned it is prejudged by the mere institution of the action or assertion of the claim. That's the objection I have to the legislation. If the legislation were in this form: that if after the United States had asserted claim and obtained judgment and there was failure to pay, they then wanted to prevent me from doing business -- although that would be a vicious piece of legislation from an international point of view -- I don't believe, as an individual, I could assert the same grounds against

it, the same argument against it.

Mr. Phillips: You see, we feel, speaking for our company, that we would not have the right justly to ask for this conference as prospective defendants, and, second, we are here asking the amount of the claim you are preparing to bring against our company, if it were not for this legislation which you regard as so essential as to prevent us from doing business. You must keep that section beforeyou in determining the equity of our case. If you contemplated such action we would hope, as friendly neighbors of a friendly country with whom we thought we were on the greatest comity, we would say we should like to know what it is all about and prepare to discuss it on the merits before proceeding. We had hoped you would receive us in that spirit independent of Section 403 and we feel doubly sure of that particularly in the light of the extraordinary provisions of that section.

Mr. Graves: Of course, that section in its effect on your company would simply require that after institution of suit, which would naturally disclose the full nature of the Government's claim, you would be required to submit to the jurisdiction in this country and to give some guaranty that you would pay the Government's claim as adjudicated in Court as a condition of doing business.

Mr. Phillips: Yes, but as it reads now, for the moment

that's on the table. We have projected legislation for submission of bond, double .....

Mr. Graves: I take it you gentlemen are aware of the modification. Are they familiar with the latest development?

Mr. Hickerson: That I don't know.

Mr. Wrong: There were various alternatives.

Mr. Graves: On the last stages of our discussion with the State Department -- and I am surprised that you gentlemen have not been told about it -- I think we had agreed that we would accept a modification which would simply require you to submit to the jurisdiction and post such a guaranty as might be fixed by the Court to assure payment of the claim in the event it was litigated in favor of the Government.

Mr. Phillips: Leaving the amount of the security to be fixed by the Court?

Mr. Graves: Yes; that is as the matter stands now. Am I wrong about that, Mr. Frank?

Mr. Frank: We even went a little farther and put a ceiling on the amount the Court could fix. Frankly, I think it might be well to go over the theory of this legislation in a broad way and that is that we consider it eminently proper and fair for the Government to take steps to see that such assets as these propsective defendants may bring into the

country shall not be liquidated in this country and taken out; deposited, as far as being responsible for any judgment. And there are any number of different ways that situation could be prevented and we have been anxious to agree with the representatives of the State Department who have taken an interest on this, on the form which would be least objectionable, to the end that these assets would be present if we do get the judgment.

Mr. Wrong: I did not have time to go into a full discussion of the three alternatives. They are all equally objectionable to the Canadian Government. They don't in any substance meet the objections we have to this legislation and I wish to say that in the view of this Government it far transcends the claims that the Treasury may prefer. They considered the preservation of the original proposals. As long as that is insisted on by the Treasury Department I don't think we have a basis for a meeting of minds.

Mr. Frank: It is a little difficult for us not to feel that it is improper for the Canadian Government to take the stand that we can't take supplemental measures to collect liabilities which may be owing to us. We can't understand why the Canadian Government should take that attitude, but I don't think that is a matter we ought to discuss

here because that is really not our province.

Mr. Hickerson: Was not our purpose not to discuss the legislation but means to make the legislation unnecessary?

Mr. Graves: But as to that, my point was this: our starting point is that if arrangements can be made that would be the same as the arrangements that would be made under the legislation, there would be no necessity for the legislation. And, of course, the legislation is really necessary because we are not in position to make those arrangements. We don't know and won't know when we are in position to institute suit as to particular defendants.

Col. Ralston: Mr. Taylor, Mr. Wrong, representing the Canadian Government has said, as I understand, the legislation in its form as introduced -- and I am afraidfrom what you gentlemen said -- that the principle of that form is still preserved in the suggested alateration which is so objectionable if one should use no stronger term, from the international point of view. He said, secondly, that lately there has been an agreement made between the United States and Canadian Governments in the trade agreement under which Canada is paying about a million dollars a week more for goods bought from the United States than the United States is paying to Canada for goods imported here and the treaty has been made, in which one of the major conces-

sions supposedly made by the United States was that there should be a reduction of $5.00 a gallon on liquor. Presumably, for that concession the Canadian Government gave certain concessions too. The effect, as Canadians see it generally, of ~~this~~ legislation of this kind would be to largely neutralize or nullify that concession to Canada. He said that it looks to him, although the gentlemen around the table said it also affects people other than Canadians, it looks to be aimed pretty well at Canadians. I don't think there can be any doubt in the minds of practical men. And, fourthly, it does disregard or overlook, for the moment, a situation in which the Canadian Government very effectively cooperated with the American Government at the time when you were endeavoring to enforce your prohibition laws. Those are representations which were made.

We are here today because notwithstanding those representations, the Canadian Government have intimated to us that the United States Government, or at least the Department of the Treasury, still feel that that legislation should go through and we are here, at the suggestion of the Canadian Government, to see if there is anything which we can do about it following a suggestion which was made, or something along

the line Mr. Graves has mentioned, that if instead of legislation something could be done by way of agreement which Mr. Graves intimates ought to follow the principles contained in the legislation, but which I think might come far short of that and still satisfy you substantially. The suggestion was made that if some arrangement of that kind could be made, legislation would be unnecessary.

We have come down here in order, before the two Governments come to grips -- I speak of "Governments" as a whole; not Departments -- before they come to grips, to see if there is any middle form. Speaking for the company which Mr. Fordyce and I represent, we have to present all objections, which Mr. Wrong has pointed out to you, and we also want to point out that the legislation, which is unusual, extraordinary --I don't know, with all due deference, Mr. Graves, I don't know of any legislation which requires that the defendant shall put up security for the amount of the debt before the judgment is recovered against it. I know of legislation which requires that if a foreign defendant happens to be in my jurisdiction then he shall put up security to compel his appearance for examination, but to put up security for a claim not yet approved, I think it is unusual. That is the startling thing that strikes one in the face with regard to this legislation.

The suggestion was made that instead of that, that possibly there might be some agreement whereby prospective defendants would put up some kind of security or give some practical assurance with regard to the satisfaction of the claim. Coming right to that and in the spirit in which we were asked to come down here, what sort of practical assurance do you have in mind and what is the amount of the practical assurance? And that involves, it seems to me, the amount of the prospective claim. And when I ask those questions I ask them reserving the fundamental position that it is not quite fair to prospective defendants to say you can't do any business with us any more although your business is legitimate and we have agreed to take your goods unless you satisfy a claim incurred in 1924 under different shareholders and different Board of Directors. I think that's unusual. That's why sovereign Governments, sovering legislatures can do anything they want to and far be it from us to interfere in domestic legislation in the United States.

I respectfully suggest if any arrangement could be made it ought to be made recognizing that principle, but to go right down to practical discussion of the matter, have you done anything in your kinds, anything tangible with regard to the so-called practical assurance; whether it is right

that we should give it or not? What does that amount to, because that would have to be the first question that would have to be answered by us, not only to our Directors, and remember! this claim does not appear as a contingent claim or otherwise on any balance sheet issued by our company, and obviously to put up bond or incur liability in any amount ought to require submission to shareholders; therefore, we ought to have that information before we discuss the form of practical assurance.

Mr. Graves: In other words, you do not feel you would have authority to give assurance of that kind without reference to the shareholders?

Col. Ralston: At the moment, I would not think so. Let's speak frankly. It might be that you, in your mind, will say This legislation has brought these fellows down here to talk to us about this matter and, after all, what the United States Government wants to do is clean up matters and we are not insisting on what has never been insisted on before: security for half or all or part, but what is that assurance you have in mind?

Mr. Graves: I think the measure is ~~fairly~~ the form set down in the most recent draft of this legislation.

Col. Ralston: If that is the draft I have in mind, that depends. Value of the goods which may be brought in currently after institution of the suit? May I say on that point, that would seem -- that can't be the true measure of security. What you are saying to us is you can't do business with us, you ....

Mr. Graves: I should have qualified that. I think the legislation does, by establishing a ceiling that it will not be in excess of the claim.

Col. Ralston: But you are saying in effect, "The gun which is pointed at you is the gun which is calculated to destroy the profit that you are going to make on current sales of goods. It isn't value.

Mr. Graves: That is not the way we view that.

Col. Ralston: That's the only thing we lose. We lose profit on the goods. You are asking us to put up a bond in the full value of the goods.

Mr. Graves: Up to the amount of the claim.

Mr. Forsythe: So many dollars per proof gallon. It is not quite the same way as Mr. Wrong explained to us.

Mr. Graves: But as Mr. Frank explained, that's our theory. Our remedy on the case of the Internal Revenue taxes is as serious as this and it amounts to an attachment of all the assets of the tax-payer. We have an even more extraordinary

protection. We use a jeopardy assessment against our own citizens. Certainly there is nothing in this remedy which we are asking Congress to provide here which is inconsistent with the remedies which we have against our own citizens for internal revenue.

Mr. Forsythe: But I wonder if there is anything in your remedies against your citizens that when the game is played in 1929 or 1930 you will change the rules in 1938? It was a stated obligation incurred in 1929 involving certain liabilities. Now the obligation is changed to involve a liability with the effect of an embargo unless you pay your old bill.

Mr. Graves: The reason we suggest an embargo is to bring the assets of these Canadian companies into a situation where we can attach them or use them in satisfaction of our claim in case we succeed in our litigation. It is no embargo. We simply reserve your assets up to the amount of the claim so that they will be available to this Government in case these claims are adjudicated against you.

Col. Ralston: We ship them in to a customer. You say, Our exaction against you is this: if you don't pay your bill we will stop you from shipping goods entirely. But instead of taking the property of the customer, they will remain your property.

Mr. Frank: Your objection is that this is a retroactive procedure?

Col. Ralston: First, it is extraordinary and, second, retroactive.

Mr. Frank: This is only a procedural change in the method of collecting claims.

Col. Ralston: But if I had a private claim, the Government would pass no such legislation to help me.

Mr. Frank: Therehave been many instances of that where they have passed laws where salaries can be attached against old claims where before they were exempt.

Mr. Forsythe: It is the general rule of procedural statutes that they are not retroactive.

Mr. Phillips: Mr. Frank, isn't it possible that the fact that we are down here is indicative of the fact that we all represent responsible clients who are appreciative of the tendency back of this legislation. You have your facilities for passing legislation similar to Section 403 in spirit and content and at any time if you find that we don't meet you in due course on the spirit I have indicated for my company. I think that is applicable to all companies. Why burden us with legislation which, in effect, means we will have to go out of business.

Mr. Graves: Excuse me! Do you think that would be the effect of the legislation in this modified form?

Mr. Phillips: There is one part and that is, what is the value? For instance, the book value of the whiskey is 50 cents a gallon.

Mr. Graves: I think it says value in the United States.

Mr. Phillips: Precisely. That would mean $2.50 a gallon import tax, $2.00 excise tax plus value of the goods, which would get us over $5.00 a gallon on the whiskey that we move. That is prohibitive. You are putting us out of business in so far as the movement of our Canadian whiskey is concerned.

Mr. Taylor: I have a suggestion to make which is that, of course, the reason for this meeting is obvious -- if there is any way the legislation can be avoided and still maintain the position of the Treasury. The Treasury is more than willing to do that. That has been told enough times. It is not necessary to repeat it. I think probably the best way to move from here is to arrange either collective or individual meetings with members of the Bureau to discuss the individual suggestions or to discuss the collective situation and then see where we get from that. We may find certain things are possible; we may find that they are not. But as far as this general meeting which is going on, I just

don't think we will get anywhere and we will make more progress if we proceed with the other idea. Do you think it would be agreeable to do that?

Mr. Phillips: As far as my company is concerned, anything that will dispose of this problem is agreeable to me.

Judge Moore: Is there a possibility of any alternative action so as to obviate legislation? We don't know what claim the Treasury intends to assert against your company, but suppose it is going to sue your company for $5,000,000. The question is whether your company would be willing to submit to the jurisdiction of the court and leave to the determination of the judge of the court the amount of the penalty of the bond. Now, in that connection, I would like to ask you this question: Let's presuppose a claim against your company of $5,000,000 and there was directed a judgment against your company for a certain amount of money. What status would that judgment have in the courts of Canada if it should be decided on in the Canadian court? Would that judgment be regarded as final, except for showing of fraud in its being obtained, or would it simply be regarded as prima facie and the opportunity given for practically a denovelle consideration?

Mr. Phillips: I am obliged to say that insofar as the Province of Quebec, it would be regarded merely as prima facie.

Judge Moore: And so in Nova Scotia, but elsewhere in Canada it could be taken as final.

Mr. Forsythe: I think everyone represented here has assets in more than one Province.

Judge Moore: Would that be sueable under the laws of Ontario?

Mr. Frank: Our investigation shows that it could be prima facie on that. We could not sue on such a claim. They would not enforce.

Judge Moore: You could sue, but the question would be how much force the judgment would have in Canadian courts. Let me ask you this question. Let us assume a suit against your company. What do you think would be the effect of an agreement -- its effect in the Canadian court, incase judgment was gotten against you in this country? What would be the effect of an agreement that your company ...

Mr. Phillips: Frankly, I can't give you a definite answer. I think if we got together and analyzed these different claims, after all different companies may have a different point of view and it is utterly impossible to get unanimity, but I thought this bill -- I know something about it. It's necessary to the gentlemen in the distillery company -- it's true a case may be directed against a Canadian company with

American affiliations to a greater degree than the Treasury realizes, but affiliations are such that the interest their companies have in this country is considerably made through affiliates of one form or another, and an attack against Canadian companies affects the value of our American assets or attacks the good will of my company in this country, so it is not an issue against the Canadian companies only.

Judge Moore: But your company has no assets subject to taxation. You probably have stockholders .....

Mr. Phillips: I would say thousands of stockholders.

Mr. Frank: I can assure you we have not overlooked that point.

Mr. Phillips: The point we wanted to make was this: that you have facilities of dealing with legislation whenever you desire. The element of time is important. I know you gentlemen want to be fair to counsel. We have Boards of Directors to report to. We approach it in an element of good faith, in a cooperative spirit, but we can't be burdened with time, when hours and days count, and I was hopeful that in the light of that observation and in the light of the general discussion that you might be willing to delete that section from the Bill; go through with the Bill that is important to the industry, and then if you find that we are

obstreperous and an altogether unpleasant lot, the majesty of the American Sovereignty can always be brought into play. There is no immediate urgency, or a week or two or a month. Let us approach the problem in the proper spirit and if we then can't arrive at an agreement it is time to speak of embargoes and what we regard as oppressive legislation.

Judge Moore: You mean negotiating a settlement?

Mr. Phillips: No, I mean clarifying the question of jurisdiction; what is the question of "practical assurance" and, in the ~~alternative~~ interim, possibly the hard-hearted Mr. Graves may soften and see the error of his ways.

Mr. Taylor: I would like to revert to my original suggestion. Not being a lawyer, but it seems to me that it is very difficult to say, Here is an individual -- we will pick out Mr. Lash, for example, whose company has not been informed of any claim. It is very difficult for him or the Treasury to discuss a claim not in existence as to amount. It really comes down to a discussion more or less like this: if such a claim were entered and I did submit to the jurisdiction of the American courts, what would I do under those circumstances to discharge any claim which might be arrived at. It's possible, because I am not a lawyer ....

Judge Moore: The definite attitude of the Treasury is

it would require a bond equal to the amount of the claim. Then you would have a factor which you could consider in discussion.

Mr. Lash: I don't see what is to be gained from going into further discussion when we don't know the amount of the claim. It would vary in each individual case.

Judge Moore: He said he is in a fog because he does not know the amount of the claim that is going to be placed against his company.

Mr. Taylor: In the light of that situation, I revert to my original thought: that either individual discussions with the individual companies(representatives of the individual companies) or else,say, discussion with all the representatives present, whichever the Bureau thinks would lead to the greatest speed of action,is the next thing in order until you do get down to rather practical discussion; for instance, various companies are incorporated in various Provinces. They have various other situations.

Judge Moore: I think if you could have some informal sort of talk, a sort of private talk ....

Mr. Wrong: Are you ready, Mr. Taylor, to go a good deal farther than the Treasury has gone in exposing the extent and natures of the claims?

Mr. Taylor: I can't tell you that, Mr. Wrong. I can see limitations, but the Treasury might not yet be ready to decide what the amount of their claim might be. It's too loose on either end to be able to talk about a specific amount, if such a thing is possible to achieve.

Mr. Forsythe: Just what was your suggestion?

Mr. Taylor: My suggestion is that the representatives who are present here discuss the matter in some detail with the representatives of the Bureau and then either individually or collectively, whichever you prefer, and then after those discussions have been concluded, we meet in this group. They can be arranged at your convenience.

Mr. Lash: What would be the nature of those discussions, or what would we discuss?

Mr. Taylor: The present situation.

Mr. Lash: The reason for this meeting, which is practical assurances which would obviate the necessity of the legislation which is now contemplated, that might be individual or it might be collectively.

Mr. Taylor: Isn't that an immediate possibility?

Mr. Lash: I don't know, because if you can't tell me what claim there is against my company, how can I know there

is a claim? As far as we are concerned, there is no claim. I am assured by Mr. Frank that he thinks there is a claim. Under those circumstances, isn't it fair for me to say, What is your claim? Tell me the nature and tell me how much it is and give me sufficient figures to go back and have the company look up and see if there is any basis for it? For a year there have been vague statements in the newspapers and we came down and tried to find out, but were told nobody could talk to us.

Mr. Taylor: Let's assume for a minute that you are a citizen of an island which shall be unnamed at the present time and you say, with complete conviction, that as far as you know the particular company which you represent is absolutely innocent. The Treasury representatives haven't had time to get around to investigating that situation. We say, Suppose when we do get around to you, we say that we have a claim which we will put through the Courts at the proper time. Then what would you do after we had gotten around to complete the investigation? Would you submit to the jurisdiction of the Courts or would you do something else?

Mr. Lash: I think that is a situation that you have to know whether it looks like there is a basis for this claim. As far as I know, you have no basis for any claim. It's

unfair for us to say we will put up something in the way of security. How is it possible to be practical unless we have some practical figures to work from and practical statements of what the claims are?

Mr. Taylor: I still suggest conversation with ....

Mr. Phillips: As far as I am concerned, I will be glad to have the conversation.

Mr. Forsythe: Mr. Lash convinced me. I have never been a defendant in large litigation myself, but I can visualize paying something to keep out of it when I see others in it, but I can't see myself paying unless someone told me how much I was going to be sued for. At my age there are proceedings that could be brought against me with success. But I find everyone here very pleasant to converse with and I say, seriously, I will be very glad with Colonel Ralston to discuss with any member of the Bureau anything that is to be discussed. I take the side of Mr. Lash -- we will have to know sometime the amount involved.

Col. Ralston: I take it Mr. Taylor's suggestion is we may know something more than we know now. That is really the subject of those conversations.

Mr. Taylor: Do you, Mr. Frank and Mr. Graves, want to start making the conferences now?

Mr. Frank: There will be two Bureaus involved. I think we will have representatives of Internal Revenue there as well as of Customs.

Judge Moore: Suppose we let these people rest on your suggestion; that we leave these gentlemen to you people and we withdraw.

Mr. Hickerson: Mr. Frank, are you prepared?

Mr. Frank: Yes; we are prepared to start right in.

Mr. Hickerson: Are you prepared to talk to the representatives of the companies individually?

Mr. Frank: No; I don't think that will be necessary.

Judge Moore: If that is the answer, we will withdraw.

The meeting adjourned for the time being.

Meeting of Representatives of Canadian Distillers and
State Department with Treasury Department
Officials in Mr. Taylor's Office,
March 31, 1936.

MR. TAYLOR: As I understand it, this is reconvening yesterday's meeting to report progress, if any. Is that correct?

MR. PHILLIPS: Yes.

MR. TAYLOR: Do you think I should call on the Treasury first or the Canadian representatives or representatives of the distillers, whichever order you prefer?

MR. PHILLIPS: I don't know that I care particularly. I think Col. Ralston is here to say something for the distillers, but the order is more or less immaterial.

MR. JACOBS: We sell the business whiskey.

MR. FORSYTHE: We have the business, but we can't sell it.

MR. TAYLOR: I seem to be looking over this way, so will you start?

COL. RALSTON: Mr. Taylor, at your suggestion, we carried on a pretty intensive discussion both yesterday afternoon and this morning and right here, for fear it might be forgotten on behalf of everyone who was here from Canada, they want me to express the most hearty appreciation of the reception that we have received and the fairness and toleration of the discussion and everything has been most agreeable. While we have not been able to agree on all the points, at the same time we have no complaint, I assure you, of the spirit in which we were met and we realize now

at a very busy time you have done a good deal to get together these busy gentlemen from the Treasury to consult on what we regard as a problem.

MR. TAYLOR: On behalf of the Treasury, I would like to reciprocate.

COL. RALSTON: Honest, we do appreciate it very generally. I think perhaps the two things I have to say had better be said from the point of view for Distilled Alcohol - and let the other gentlemen say. Perhaps you will again permit me to get a running start because I take it this may be one of the closing conferences we will have. You asked us yesterday to go and consider with the officials of the Treasury the matter, particularly the matter mentioned, of practical assurances, which was the phrase which had been used by some - possibly getting together and in that connection we think it was rather intimated that it might be disclosed in that discussion the extent of the claims. We went into session and I think I can say that there emerged the following points: First, with regard to the legislation. You have here some amendments to the legislation which have been made and which Mr. Wrong had mentioned to me, or at least he has three drafts and you had one of the three drafts, although I am not quite sure that the draft Mr. Wrong had, the draft which is here or which was mentioned from time to time, was in text exactly any one of the three drafts.

MR. TAYLOR: No, I think in order to clarify that point, all those were suggestions for amendments which have not been presented as yet to the committees of Congress so that probably explains the discrepancy.

COL. RALSTON: I don't think that we have seen, except on the table in our discussions in Room 280, the exact suggested draft.

MR. TAYLOR: They were all attempts to reach for a more satisfactory form; nothing official about any one of them.

COL. RALSTON: I don't think we have seen the latest draft of the reconciliation of the views of those concerned with the measure, but I think the result can be summed up in four points which I want to make. The effect of the legislation, Mr. Taylor, as we interpret it is this. First, to compel the Canadian companies to furnish security for the payment of an undisclosed claim. Second, that the security which is to be furnished is in connection with a claim alleged to have arisen years ago when no such legislation was in existence; in other words, it is ex post facto legislation. Third, that the security which is required to be furnished by the companies is asked of them even though the claim is not against the companies, but is against some individual who has now a substantial interest in the company, even though that individual may have had no connection whatever with the company at the time the alleged claim arose

and even though the present management and the present directors and the present shareholders are entirely innocent and ignorant of the transaction on which the claim is alleged. Fourth, the security proposed under this legislation was to be in advance and before the claim was established. Fifth, that that security would require the companies to either bring in the person, this individual who was alleged to be the defaulter, and make him submit to the jurisdiction of the court or else submit to their goods being embargoed. That is to say, if the charge was against an individual, the companies, no matter how much security they gave, would still be required to bring that individual in and make him submit to the court. Otherwise the embargo would be enforced - two conditions that would have to be complied with by the company and the panalty for not complying with that ex post facto legislation and for what we submit so unprecedented demands made by that legislation is embargo of the goods of the companies concerned. Now that's the nature of the legislation we discussed.

The Canadian Government made representations to which I referred briefly yesterday and which I will not repeat today. You all have them in mind although we feel that these representations ought to receive at your hands and particularly,if I may say so, at the hands of the Government, further consideration, reserving all those objections. The suggestion was there

might be some way of giving practical assurance and we went into the conference with the Treasury officials in connection with that to explore the possibilities of that. We found, Mr. Taylor, that practical assurances - we found immediately that practical assurances were impossible in the sense of giving security when we found that Mr. Graves and the Treasury officials felt that they were not in a position to disclose the amount of the claim. There does not seem to be much possibility of giving practical assurance for an unknown and unnamed claim which has not been assembled, let alone litigated. Then we launched on the exploration to see if - well, practical assurances can't be given in the sense of some definite security in view of the fact that the claim or the amount of the claim has not been disclosed or can't be disclosed - is there some substitution for this legislation to obtain the objectives of this legislation as laid down by the Treasury and in that connection we examined the legislation in the light of the features I mentioned when I began and I really think that I can submit with a fair degree of confidence that the Canadian companies demonstrated to Mr. Graves and to the other gentlemen who were there that this legislation as a collection measure would be futile; that is to say that the suggestion was that - the position was this - the Canadian

companies value their liquor at fifty cents a gallon. It comes in here and pays a duty of $2.50 and pays another $2 excise tax; that is five dollars. Mr. Graves was saying to us in connection with any security that is given we would regard the value of the liquor as six dollars so in so far as the value of the liquor is to be the measure of the security, six dollars is the outside value. That means that the Canadian companies send liquor down here and what is only fifty cents value on their books has to grow to six dollars when it comes to a matter of security, which means that when they furnish bond and furnish security to the surety company back of the bond they have to dig down in order to find security or properties worth six dollars for each gallon, in addition to the liquor itself. On the face of it it would appear it is just impossible for the Canadian companies to furnish any security of that kind and I say the legislation is futile. What is the alternative? It is that the Canadian companies simply cannot send in their liquor. The result is America loses its customs duties and Mr. Graves quite properly does not admit they lose as well their excise tax because that excise will be paid on American liquor. We are not so sure and Mr. Phillips made the point that it would increase the demand both for American liquor as well as Canadian. However, be that as it may. The

legislation in its result is this. We will embargo your liquor if you don't fulfill our condition and the condition which they impose is equally impossible and means in effect an embargo on the liquor. Under the circumstances, we submit that this would be futile as a collection measure. That is a matter for you, Mr. Graves, and the other; not for us. We have been given an opportunity to present our views. We suggest that the law of diminishing returns can apply to this as well as to anything else and the more you press this claim the less revenue you get and if you press your alleged debtor so hard it simply means he hasn't anything to pay with. We say, therefore, that the legislation is futile as a collection measure. We have already submitted it is confiscatory from our point of view in affecting people who were entirely innocent of the transactions which gave rise to the claim and as Mr. Lash pointed out very pointedly, the legislation itself does not reach objectives, we suggest, which Mr. Graves and the Treasury people have in mind in two respects. They say No. 1, we want to confer jurisdiction upon American courts and No. 2, we want to provide security. We say, No. 1, it does not confer jurisdiction on the American courts, all it does is to say to an individual outside, if you don't submit, certain things will be done, and the conditions are so onerous,

we can't carry it through. Secondly, with regard to providing the security - the conditions with regard to provision of security, is so onerous that they can't be carried out and that therefore we submit the legislation does fail of the two objectives which Mr. Graves had in mind. Therefore, it seemed impossible to deal concretely with the matter of practical assurances and second, impossible to deal with a substitute for the legislation when, we submit, the legislation from a collection point of view is more or less - more or less a stalemate and you can't substitute zero for zero. Then the other point was is there any other alternative possible at all for a way out of this whole situation and Mr. Phillips made the suggestion, which we submit has merit and which we think you might well consider. We suggest to you, of course entirely without prejudice speaking for Canadian distilled alcohol, that absolutely there is no legitimate claim against our company, but we say to you money is what you want, money you think you are entitled to. It does not matter whether it is litigated or how it is worked out or get a reasonable settlement in case the debtor is not able to pay the full amount. So to continue in the spirit of the conference which has already been held, we suggest No. 1, as soon as you are ready, representatives of the

Canadian industrial alcohol will come down here and sit around the table and discuss with Mr. Graves and the other gentlemen as soon as they are able to tell the amount of the claim, its nature, and discuss arrangements for the claim, if we are reasonably convinced that there is a claim and after all, that is the practical thing which Mr. Graves and his friends are trying to carry out in this connection and I am sure that there is no attempt whatever to harass. It is an endeavor to make the best showing for the Treasury. Mr. Phillips added this suggestion that the companies would be prepared to consider some assurances that they would not increase their exports to the United States save in the normal operation of the business during the course of these negotiations. It may have been in your minds, something to the effect that we endeavor to beat the gun by getting stuff in here while the legislation is not on. That is not so. In the nine months the legislation has been on the table of the House that has not been done, you may be sure.

Another suggestion which we did not make to Mr. Graves and his friends, but which Mr. Forsythe and I have discussed from the point of view of our company and that would be that during the negotiations that some assurances - we would consider giving some assurances that we would not adopt any

method of disposing of our assets which would affect the present position of the Treasury Department with regard to ultimate collection of any claims. That certainly gives you assurances that your present position is preserved. It gives opportunity for discussion and in the meantime it removes from the Treasury - the United States Government Treasury - all necessity of having to press this; I am sure what to you is disagreeable legislation. It is not legislation that anybody is very happy about and at the same time it gives some estimate of good faith on our part. We asked Mr. Graves if he had any suggestions to make along this line and he said as far as the Treasury was concerned, they had no other suggestions to make than those which were made in the legislation.

That concludes my very brief and hurried little disconnected report of what has taken place in there, bringing you up to date, and which we present to you in the hope that opportunity may be found of meeting these suggestions which we have made in dealing with the whole matter.

MR. TAYLOR: For my own purpose, on the five points which you mentioned at the start, effects of the legislation, I had some difficulty in recognizing certain ones of those. That is possible on account of ignorance on my part. Do you think it would be helpful to have Mr. Frank or Mr. Graves comment on each one

of those two sections? I know it would be from my own standpoint.

COL. RALSTON: Perfectly proper and informative to us.

MR. LASH: May I before that add one little word? I think it has been fairly well established that there are approximately 16,000,000 gallons of whiskey in Canada which would ordinarily find its way in the United States over a period. That 16,000,000 is subject to an import tax of $2.50, making $40,000,000. The interest of the United States Government in that whiskey in Canada, at the moment assuming the possibility of bringing it in, is considerably greater than the interest of the Canadian government and the distillers, if this legislation or any agreement is to the effect that there shall be an embargo or if not an embargo, an impossible agreement - I mean by impossible agreement an agreement impossible of performance by the Canadian distillers because, the United States has said in effect they shall not trade - that has the effect of losing a potential $40,000,000 of revenue to the United States Government and it does not in any way confer any jurisdiction on the United States courts which they have not now, nor does it afford any means of security. There is only the whiskey to which the United States Government can look for its claims. I think that is a fair statement. There are hundreds of buildings, but that would

not do much good. If the United States were given that 16,000,000 gallons of whiskey today, what good would it be to them? How could they dispose of it if they got judgment? If the Canadian courts were willing to entertain this judgment they could not sell that whiskey in Canada because of government control in the various provinces and they would have nobody but the provinces to sell to. They would have to take that whiskey in thousands and thousands and thousands of barrels over into the United States and then what could they do with it? The only method I can think of to have that whiskey marketed is through the ordinary channels of trade. That would result in $40,000,000 income to the United States irrespective of the other portions of the revenue which, as Mr. Graves pointed out, may be fairly regarded as displacements of the local product and we think those are two points which should be very carefully considered in connection with the situation as to whether or not this section is advisable.

MR. TAYLOR: I am afraid I can't talk about mathematics.

MR. LASH: That is only two and a half times sixteen.

MR. HICKERSON: I thought the total stocks were about thirty or 32 million.

MR. LASH: I think stocks are somewhere in that neighborhood, but that includes various other types of whiskey for use in Canada and they are extra.

MR. FRANK: Imperial gallon?

MR. LASH: Imperial gallon.

MR. PHILLIPS: With your permission, Mr. Taylor, (1), I would like to make -- rather to emphasize that I am hopeful that the efforts of the Canadian distillers through their counsels have at least been successful to the point of convincing the representatives of the Treasury that we are here in good faith in an effort to solve the problem. It is true that although the conference has been restricted to Section 403, you can hardly blame us if we avail ourselves of the opportunity to impress upon representatives of the Treasury our good faith. There are two ways of determining that: (1) With respect to the cooperation in the past, that is, since the legislation was first introduced and (2) judge us whether our assurances are worth anything or not. I pointed out that although this legislation was introduced last June, as a matter of fact none of the Canadian distillers have attempted to reorganize their companies or to move into America in an indirect way other than the normal requirements having regard to the nature of their business. The purpose of the legislation is in due course to direct litigation against Canadian companies and in the final analysis

the possibility of cashing in on the judgment is on the whiskey. If the legislation were eliminated and if the Canadian corporations gave assurances that they would sit around the table with your officials in an attempt to arrive at a settlement, even though you could not deal with this legislation before the next session of Congress, a great portion of that whiskey would be moved and with respect to that, therefore, you would have derived a revenue of at least $2.50 a gallon because the whiskey would be moved into the United States. I would like to make one last observation and that is this: That these Canadian counsels were acting in good faith. You must appreciate that. If we had relied on the cooperation of our Government in presenting the objections to this legislation, by the same token we are under serious obligation to our Government to show good faith. Quite apart from our personal status as counsel, we are under a serious responsibility to our own Government and if we do not discharge our responsibility, I am sure we will hear from them.

MR. TAYLOR: I think that is an excellent point. Very glad you mentioned it.

MR. PHILLIPS: In that spirit I have requested Mr. Graves in the light that we have only marketed our whiskey normally and only a small amount of that, even if Congress adjourns as long as we con-

fine our business to our normal course of operations and because of the fact that you will be at least getting some revenue on the very whiskey that we have been moving and, I might say, in the almost cordial way you have received us. Please have some confidence in the Canadian distillers through their representatives that we want to be fair. We realize that the legislation having gone as far as it has -- but why not test us out and see if it is worth while to take that gamble. My guess is we will deal in that matter in the proper spirit and will maintain an attitude with which you will be satisfied in the final analysis. All I ask is that the Treasury will appreciate our status as counsel and give us a Bill of Complaint so we can exercise our duty and talk to our clients.

MR. TAYLOR: I'm glad you emphasized certain things. For example, the spirit which made this conference possible because it has obviously been helpful in getting a common solution of a difficult situation which might avoid all the rough spots, for want of a better word, that might arise out of the situation. And I would just like to repeat that the Treasury does appreciate the spirit in which you have approached this. I would like to have some other comments about this particular situation to clear up any misunderstanding which might exist as to the various points which Colonel Ralston mentioned. Are you prepared to take them one at a time because I had

difficulty recognizing certain points of the legislation.

MR. FRANK: I won't be able to remember all of the points; maybe one or two.

COL. RALSTON: The first point was, I said the effect of the legislation was (1) to compel Canadian companies to furnish security for undisclosed claims.

MR. FRANK: That, of course, will not require any change in the legislation. One of the principal reasons we did not disclose the amount of the claim was because you would not want it disclosed with your competitors present. Also it would not have been possible to disclose the amounts of claims against those companies not represented here but since the object of the meeting was to decide how generally the Government might be secured in the event that jurisdiction could be acquired against all of these companies and how it could be secured to know that it could collect any judgments which might be rendered against all of the companies, we did not deem disclosure of the amounts of the claims as part of the issue.

MR. TAYLOR: That is not quite what I had in mind. No security is asked under any circumstances until the claim is made and then claim will be made. You are not asking security for an undisclosed claim when it is disclosed you do ask for.....

MR. FORSYTHE: Isn't this true? You say you are not asking security for an undisclosed claim. We have been trying to devolve a substitute for the legislation and the only substitute according to the Treasury is some substitute which gives them exactly what they have there. You can deal individually or collectively but how can anybody with every day regard for every day business sit down and formulate anything which will enable him to propose a security for an amount he does not know?

MR. TAYLOR: There are obvious difficulties but the point I want to clarify is -- let's assume just for the moment that you are manufacturers of whiskey a year from now. After investigation we find that there is a claim against you. That claim is then filed in the usual manner, etc. through the courts and let's say that that claim is for a million dollars. At the time the claim is filed that million dollars obviously will be the amount that is being argued about and you will ask for security for that particular amount at that time.

MR. FORSYTHE: Yes, that's very obvious.

MR. TAYLOR: That's my understanding.

MR. FORSYTHE: Yes, that's very obvious.

MR. TAYLOR: I don't see the fact that that particular amount is undisclosed at this particular time has any bearing on the type of security that will be asked for.

MR. WRONG: I think as far as the Canadian companies are concerned, the amount of the claim is nebulous in either form or astronomical to say the least. I hope we get a little more elucidation on that subject before we adjourn.

MR. TAYLOR: I'm asking a lot of questions -- probably some of them stupid.

MR. WRONG: I used the word "astronomical". The only indication I have seen in any official document in this country appeared in the report of the Ways and Means Committee of the House of Representatives on this bill and in that bill $100,000,000 was specified, based, I assume, on information furnished by the Treasury Department. That, I submit, is an astronomical figure.

MR. TAYLOR: It is more than possible that included estimated claims for other countries.

MR. GRAVES: Yes.

MR. LASH: It did say that it was mostly from Canada.

MR. TAYLOR: There is a French claim which might be in existence. That's obviously included in that and the amount of the claim established at some future date might apply to other countries.

MR. FORSYTHE: Mr. Lash says, and I remember the words, that the one hundred million mentioned was mentioned as mostly from Canada and "mostly from Canada" certainly means to the extent of fifty million dollars. I don't know whether any of your people have ever taken the trouble to do it but if you do, you can take the distillers in Canada and you can take their net asset

position, deduct their liabilities in Canada and take the distilleries and I doubt if you would get fifty million dollars. Now then, that being so, I say unless some particularity can be given to this thing, it is so impossible to sit down and say to Mr. Graves: I propose that we will have this security or that other one give you some security on our property, or both, representing security on our property because I could not commit my company to give security for a claim that is double the net assets of its position. That's why I say -- It's all very well to say whenever we formulate this claim and put it through court, you will know then what it is. Of course, yes. And if I have committed myself beforehand to give some form of security I have made a jackass of myself. You have to talk mathematics in a proposition of that kind and the mathematics are simply impossible. If you tell me a claim when formulated against the Canadian Industrial Alcohol will be five million or one million, then I can sit down with Mr. Graves and say: Here are the figures of my company. You can go up there and look at the books and take an inventory of its assets and perhaps you can tell me some way I can give security for that amount. That's why I say to talk about a substitute for legislation for an amount you don't know

anything about is an extremely difficult thing.

MR. TAYLOR: While we are on the question of security, there is one question about several of the statements made here. There apparently was a direct relationship established between some particular whiskey which is now in Canada, and the particular claims. In other words, let's say that those assets are in some particular concern which is to be a defendant. Is there a relation there or does that mean only available assets?

MR. FORSYTHE: Only available assets.

MR. TAYLOR: Why?

MR. FORSYTHE: Because I don't know about the other companies but I can say for Industrial Alcohol that normal operations and sales it makes of other American type whiskey won't pay its overhead. We have on inventory approximately six million gallons. I know a statement was made in 1934 that we had approximately seven million gallons of American type whiskey. I presume it has been reduced. Then that means -- take the six million gallons of American type whiskey at 50¢, that's $3,000,000. That means that half the asset position of that company is locked up in that American whiskey. There is no possibility of its realization.

MR. TAYLOR: It's a figure of speech rather than an actuality.

MR. FORSYTHE: It may be theory but a sound one.

MR. TAYLOR: It was such an unusual statement that I thought I would explore it.

MR. FORSYTHE: Mr. Taylor, the Treasury officials did agree that American type

whiskey affords the only asset.

MR. TAYLOR: It does not mean though that they are the only asset.

MR. FORSYTHE: Oh, no, but I say you take the position of my company. They represent over half the total assets and part of our assets consist of the item that I was ready to assign (laughter) two million dollars of good will. If I may make this further observation, the thing that struck me as being most astounding is that we were told very directly by Mr. Graves and others that the two primary objectives of this legislation were to acquire jurisdiction over the proposed defendants and to get some clamp on the assets so they would be available to respond to judgment if obtained. One of the things that struck me as singular is the provision that action might be brought against an individual.

MR. TAYLOR: I'm glad you mentioned that.

MR. FORSYTHE: And if he happened to be a substantial owner of my stock, no matter what action is brought against him, my liquor can be kept out of the United States until that individual has submitted to the jurisdiction of your courts. How in heaven's name could I compel someone else because he is a stockholder of my company to submit to the jurisdiction of your courts! I couldn't do it. And that must be done because if you can get jurisdiction, you can't execute over his property. I might get all the security in the world but if my friend,

Colonel Ralston, had put a claim against me and he acquired shares of the Canadian Industrial, then my goods have to be embargoed until he submits to the jurisdiction of your courts.

MR. TAYLOR: Mr. Frank, would you like to comment on that?

MR. FRANK: The only comment I can make, I know what was intended and that was to prevent intercorporate changes, which we were talking about this morning. When Mr. Phillips mentioned that none of those things had taken place, I can only say it certainly is not contemplated that any subsequent acquisition of stock in Canadian Industrial by a man who ran a rum boat in from St. Pierre.....

MR. WRONG: But you have that power in this legislation.

MR. FRANK: Substantial interest must be taken in connection with control.

COL.RALSTON: I'll bet Mr. Frank half of the good will of my company against a good cigar that where you say "whenever the Secretary of the Treasury finds there has been instituted proceedings;..... after such notification of Collector of Customs, etc.," -- You don't have to go any further. It's preposterous!

MR. WRONG: Let's take an extreme example which will not correspond to any of the claims. Supposing I am engaged in the rum-running business in Cuba during Prohibition in 1933. Having cashed in on my ill-gotten goods, I moved to Canada and invested in stocks in well regulated distilleries in Canada. You have any evidence

you like against me down here, but I remain outside your jurisdiction. You could declare a complete embargo against the import of Canadian liquors into the United States if you choose to use those powers. Now I say nothing is likely to happen, but it does show the extraordinary power that is being sought in this bill.

MR. JACOBS: Nothing to prevent rum-runners from buying stock on the open market.

MR. WRONG: The company would not have any control over a man who purchased stocks in the open market.

MR. TAYLOR: Is that No. 2 that we skip to?

COL.RALSTON: The fact that this legislation is being passed in connection with a claim which arose years ago when no such legislation was in force, it seems to me, is an objection which ought to be taken full account of and gives grounds for the most serious consideration of an act of this kind. It is opportuneless legislation. It is being passed to cover something that happened a long time ago; passed for the present in connection with the past. We already have some ex post facto legislation in Canada with regard to our income tax act. But I am glad to say that the legislation which was made retroactive was a provision in the income tax law which allowed a man 10% on his last year's income tax, and we all said we were glad of that.

MR. FRANK: If this legislation for setting up a new claim or a new obligation on the part of people who had taken part in transactions in the past -- I think the transaction can be well taken -- but it is not that kind of legislation at all. The obligation, if it is an obligation, exists. This is simply furnishing to the United States Government other proceedings under which it can get jurisdiction, or get means of satisfying an obligation which either exists or does not exist and has a great many precedents in our revenue laws. And the way we treat our own people all the time, as was pointed out yesterday, it has precedence. When salaries have previously not been attachable, they become attachable. The individual in this country then has to respond to an obligation which he has incurred which never could be collected. This is a means of collecting an obligation.

MR. LASH: Is that right? Assume that this importer, whoever he was during Prohibition, came up to one of your Treasury officials and said: I have brought in one case of whiskey. Here is $36.00. You would not have taken it - you could not have taken it under the law. Now then, your situation seems to me to be getting right back to the custom which is entirely

different from the ordinary procedural enforcement. You are going back in an endeavor to collect something that you had no power to take at the time. You are creating now this remedy which deals with that past situation.

MR. FRANK: There is no doubt that there was a legal obligation to pay this amount of money, for which we will sue, for introduction of such liquors into the United States.

MR. LASH: But could you take it? Suppose a fellow came in with one thousand cases of whiskey and sailed it into Washington, heaved it overboard, and gave it to the men?

MR. FRANK: We would certainly have said you could not bring it in. He has not imported it - he has simply smuggled it in. After he has smuggled it in, he is liable.

COL.RALSTON: What you are doing is saying that that company can't sell liquor. That has nothing to do with the liability. I am a new shareholder in Canadian Industrial and I read the United States Treaty and I found a reduction in duty. I think it is a good time to buy Canadian Industrial. I find now retroactive legislation applying to transactions in 1929, whereby if you are not going to collect this claim, you can't do business with the United States.

MR. FORSYTHE: And further, you say this is not something new in the sense of creating a new obligation. But take this case.

Suppose that in 1927 some person -- a large shareholder of Canadian Industrial Alcohol -- came to them and made a purchase; the sale made by bona fide alcohol companies. The purchaser says: I am going to take that into the United States. Assuming any knowledge on the part of Canadians that there would have been any obligation on the part of the Canadian Industrial to pay you any duties, but under the legislation you proceed against that man. He is a large shareholder and thus you have to stand behind him. That was certainly an obligation I did not have in 1927, but it is an obligation created by this statute.

MR. TAYLOR: Youare getting back to the other point.

MR. FORSYTHE: But this is the creation of an obligation, a new obligation, in this case. We have to dispose of our goods legally.

MR. PHILLIPS: The value of the embargo cannot be greater than the intrinsic value of the whiskey to the Canadian companies. In the past we have moved whiskey normally. Reasonable delay does not do away with the right you may see fit to exercise, but certainly in the laws that have reason, and having regard to the international features, isn't it worth while? The bigger you are, the finer you are. You can afford to drop this legislation for the time and give the prospective defendants

an opportunity to sit in on the conference and if, in the final analysis, no solution is arrived at, the remedy -- after all, Canada and the United States are friendly countries -- we hope that you will be better disposed towards us. We know that you are not now, at least to the extent we would like to see. And I am fighting for that chance and I don't think there is any real loss to the Treasury -- on the contrary revenue of this country will be derived during the delay you give us. Surely that is logical, and that is a logical and consistent position, and one that is not unfair and we feel that the Canadian citizen -- this Government is big enough, broad enough, and fair enough if we throw down that chip, to play chip for chip with us and see what can be done.

COL. RALSTON: It is unwise legislation which requires a defendant to put up security before his claim has been adjudicated. That seems contrary to all the things I know regarding security. But I may say this - that the United States Treasury is in a very different position from an ordinary private creditor. No private creditor has such powers as this. We think you should separate the executive from the legislative. I mean, I think Government bills ought to be collected on the same basis that any other bills

are. If there is legislation at the time the transactions are incurred, and it applies to them, then all right. But legislation passed, first, to restrict trade and, second, to require the defendant to do what he generally does not do in regard to putting up security before his claim has been adjudicated, is not the kind of legislation which is amicable to Canadians at this time.

MR. FRANK: You can start out by attaching it. All that would be required here is putting up security at the time of institution of the suit.

COL. RALSTON: If you have provision that he put up security, you don't have.....

MR. FRANK: You can attach assets in the jurisdiction. The liquor that is being brought into the country is the asset against which we will have to go. And this is closely analagous to where we will have to get the asset.

MR. PHILLIPS: The answer is, if you square the circle, if the whiskey is the asset, then aside from the fact that in the movement of that whiskey you get $40,000,000, it would be advantageous to you to allow us to do business. As I said yesterday, if I were in your place, I would say to the Canadian distillers: we will sue you if you don't move that whiskey, because if you do, we will get $40,000,000.

MR. WRONG: The operation would be so successful, the patient would promptly die.

MR. TAYLOR: Talking about security difficulties would be worth while at this time.

COL. RALSTON: They are all the same.

MR. TAYLOR: In other words, you don't think any implication of the provisions would be of particular interest.

MR. FRANK: It might be.

MR. FORSYTHE: You say you have something that is worth 50¢ and you bring it into the United States and by paying a $2.50 customs tax and putting up another two dollars and a half you make it $6.00, and that is almost impossible. That is the security basis for all that I have seen. It would simply mean that if Industrial Alcohol brought in 10,000,000 gallons into the United States, let's assume excise and other taxes out of the way, they were going to receive $20,000. That is $2.00 a gallon your Government would have to receive, in respect to that $4.50, which is $45,000 paid either by the importer or ourselves. But at the same time, we have to put up another $45,000. Assuming we have $20,000 and can hand that to a bonding company, or

pay to your collector, we have to hand over another $45,000 that just does not exist. It is commercially impossible. You take Canadian Industrial. If you cut out the $45,000 and said, give us $20,000 that you got from the American purchaser, we have to pay the expenses of moving that whiskey and to pay the expenses of selling it. If we gave you $20,000, we have a liquid position of less than one million. It wouldn't take any time to tie up five hundred thousand. Moving a million gallons of whiskey, would mean that, and the company would be insolvent.

MR. TAYLOR: The reason I asked the question was, as I remember it, there were two series of alternatives.

MR. FORSYTHE: They all amount to the same.

MR. FRANK: I don't think so. I think there are any number of plans which may be followed under those alternatives. That was the one, Mr. Forsythe, you were most interested in, but there were all sorts of arrangements that can be made under reasonable terms to be agreed upon by the Secretary.

MR. FORSYTHE: I have been bothered very much by two words. One is "Substantial" and the other "Reasonable" and I have found that the other fellows leave "Substantial" out. I can't conceive -- you talk about the Court being asked to order security. I have never heard of a Court being asked to

order security for an amount in litigation, or that the security should be less than the amount of the claim. The Court is always bound to take the view that the claim put forward is a serious claim and that the person putting it forward expects to get it all. And if security is ordered, it is ordered for all of it.

MR. FRANK: It was not our idea to have the Court fix the amount. We understood that would be more acceptable to you people, but we have always had, in a measure, the phrase "or other reasonable security to be fixed by the Secretary of the Treasury". Under that, there are any number of schemes which are possible; warehouse receipts which we will be glad to go into.

MR. FORSYTHE: But you will come back to this thing. If you don't want anything else from me but the actual net proceeds from my sale, that is, $2.00, I say there is not any claim which involves anything like a small amount as that. The warehouse receipts gives you the whiskey, - a trust receipt for the proceeds. I can't finance on that when it is in the hands of the United States Government. Or I give you cash or a bond - it is all the same because they take everything.

MR. FRANK: That is certainly contemplated where we don't see that the assets are not available.

MR. FORSYTHE: Well, I can't carry on my business.

MR. FRANK: We are going to have everything back if we are successful and we are entitled to it if we are successful.

MR. WRONG: After you have gotten your judgment.

MR. FRANK: By that time there would not be anything for us to get.

MR. WRONG: I think you can accept the statements of the Canadian Government.

MR. FORSYTHE: If tomorrow morning, or this afternoon, I say if the Treasury Department is prepared to say how much I owe, they may reasonably expect to get Mr. Hill to sit down with them tomorrow.

MR. FRANK: That's exactly what we will do when we are ready to begin these proceedings. But we did not understand this was the purpose of the talks. These talks were to be general.

MR. FORSYTHE: The generality of it is just this. You are saying, in effect, when I have gotten that legislation in such shape that I can prohibit you from doing any business at all, then I am prepared to talk to you about my claim. That conveys to me the idea because it would not be fair to you people to say, but it is an inference that may fairly be drawn from that, and that is that. If we got into a

discussion of what is "reasonable" you might be inclined to support the reasonableness of his side by the fact that that legislation existed. If that is the attitude the Treasury wants to take about it, I can't influence you on that at all, but I do say that it is hardly the spirit in which I hoped to approach this problem. I can't believe that it is essential to a problem of this kind, that one person should have a weapon in his hands. With due deference he says we shall keep your whiskey out - quit business. If that's the way to discuss a matter of that kind, that's the way to discuss it. But I do say, even if that were the attitude of the Treasury -- After all, they tell us all they want is the money and the money they think they are properly entitled to. During the interim, while we discuss that thing, if they find me unreasonable, the house of Gross & Son will still be here and my asset position will be just the same relatively as it is today. I can't see that the Treasury suffers any prejudice on that. If they find they need a club to beat me into submission, they can get it, but it does not seem the proper way to approach it.

MR. TAYLOR: Have we commented on all the points which were made?

COL. RALSTON: Yes. I still am very strong on the proposition made -- I never heard that security for costs is given for a debt before the debt is liquidated -- the nature of legislation which requires that the defendant shall put up security immediately upon assertion by the plaintiff of a claim. It does not cost the Treasury anything to launch proceedings. That is just the beginning, and that, seems to us, sets a new set of machinery going altogether with implications that are tremendous, simply because the Treasury desires to assert a claim. After judgment has been recovered and a man wants to appeal, then he secures a writ to respond to the judgment. But he never had to give security when the writ was issued and here is an additional objection. This does not give security, but this says, if you don't do something else, and if you want to trade legitimately with this company, you have to put up security. It seems to me it puts in the Department of the Treasury trade matters which I suppose are in the Department of Commerce. It is not a matter you deal with generally at all.

MR. TAYLOR: I think that these discussions which we have had have certainly been helpful, as far as explaining to the

Treasury certain things which they may have been conscious of before and certain things in which there might have been minor confusion. In other words, I am glad the discussions have taken place. I think the suggestion I would have is that unless there is some other particular subject which can come up at the present time, why we say, thank you very much; we would like to think about the points which have been raised; there certainly are a series of them which I think should be given every consideration, not so much the possibility of changing the Treasury's point of view as simply to be sure that we have explored all the aspects of the legislation, its effects, etc., and after that, it should not take too long; in other words, the very quick check. We will get in touch with Mr. Wrong to find out. I do not say this will be in the next few days. I would not suggest that you gentlemen stay down in anticipation of that, but we will, let's say, restate our position or state our position not later than the end of the week and I would suggest that we could communicate that to you, Mr. Hickerson or Mr. Wrong, direct.

MR. HICKERSON: We can arrange that between us. The reason for that look is that I have been trying to get away to Ottawa for three weeks.

MR. TAYLOR: Well, Mr. Hickerson, you can reach him up there as well as here.

MR. WRONG: I will stay here.

I should just like to say, to urge on you, the point of view of my Government on the desirability of seeing if possible if you can dispose of the legislation, either as part of the present bill, at worst the present bill, with the possibility of bringing it in later in the session, or preferably, at any rate, until the next session of Congress meet. These gentlemen have explained so far as the companies are concerned and their assets are not likely to be severely depleted in the course of the next eight or nine months and that furthermore, the revenue will benefit your country. They will not undertake to increase their shipments to this country beyond normal; they will maintain their shipments at normal volume.

MR. FORSYTHE: To be fair, I understand Industrial Alcohol within some months have negotiated certain contracts, but the contracts exist. It will be in the normal course of their business.

MR. LASH: I can't undertake to give definite word on that.

MR. WRONG: My concern is to avoid difficulty and I think I can use the words "grave situation" which will develop if this legislation goes through in the next two weeks at this session.

MR. TAYLOR: There are certain aspects of that situation which we can discuss at another time.

MR. WRONG: I quite understand that, but I wanted to say that before this meeting broke up.

MR. TAYLOR: All right. Thank you very much, gentlemen, for the very nice reception we have had.

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TREASURY DEPARTMENT

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INTER OFFICE COMMUNICATION

DATE March 31, 1935

TO Secretary Morgenthau

FROM Herman Oliphant

Please speak to me about this. I believe it is not complete. HO

Mr. Wrong stated at the conference this morning that when the State Department official handed him the Treasury statement at the time the Canadian Trade Agreement was signed, he said, in substance, "Read this. I want no comments." Mr. Wrong went on to say that he glanced at it and assumed that it was a statement by the Treasury and not by the United States Government.

In this connection, I attach a revised copy of my statement of what happened at the time which sets out in detail and specifically just what happened and refers to the personal witnesses and records which are available to establish these details. Particular attention is called to the last paragraph on page 2 and the following paragraph.

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.

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, Mr. Oliphant, Mr. Opper 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 the conversation with Mr. Hickerson.

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. Opper, 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.

COPY

From Mr. Wrong, via State Department and Mr. Taylor

MEMORANDUM SUMMARY OF DISCUSSIONS BETWEEN REPRESENTATIVES OF DISTILLERS - SEAGRAMS, HIRAM WALKER & SONS, LIMITED -- GOODERHAM & WORTS, LIMITED, CANADIAN INDUSTRIAL ALCOHOL - AND REPRESENTATIVES OF THE UNITED STATES TREASURY.

At the original discussions which took place on Monday, March 30th, at which not only the Treasury Department, but the Department of the Secretary of State was represented, it was suggested that discussions with representatives of the Treasury only might bring us nearer the solution of the problem, with the consequence that, after general discussions of the legislation, the representatives of the Secretary of State retired and more particular discussions ensued. At the subsequent conference, which was adjourned to and continued on Tuesday, March 31st, the Treasury officials stated their position to be as follows:

They seek by the legislation a two-fold objective: First, to acquire jurisdiction over all persons, including the Canadian companies, against whom they may assert claims for duties or other taxes arising out of alleged illegal importations of liquors into the United States prior to the repeal of the 18th Amendment; second, they seek to compel some form of security which will enable them, in the event of a favourable judgment upon their claims, to be assured

of

of payment of such judgment. Examination of the legislation itself shows that they propose to acquire jurisdiction not only over the companies whose products may have been imported into the United States, but also over individuals who may have imported these or any other products into the United States, and to compel the company, even though the claim be against an individual, to furnish security for the claim against such individual, if it can be shown that the latter has any substantial interest in the company.

Generally speaking, the method proposed is that, if proceedings are instituted for the recovery of such claims as have been mentioned, the Secretary of the Treasury may impose an embargo upon the importation of the goods of the company concerned unless the defendant, whether company or individual, submits to the jurisdiction and security is furnished equivalent to the fair market value in the United States of any liquors sought to be imported into the United States after the institution of the proceedings, the total quantum of security to be limited to the total amount of the claim. It is true that certain alternative proposals as to security appear in the legislation, but after discussion it became only too clear that the financial burden upon the company giving the security would be in no way lessened by the adoption of any of the alternatives.

The representatives of the distilleries came to Washington prepared to discuss with the Treasury Department the nature

nature and extent of the claims and the possibility of actual settlement in case any claim appeared to be reasonably established, which would, if achieved, render needless the request of the Treasury Department for legislation. The Treasury Department at the earlier stages of the conference indicated that they were not prepared to discuss the nature and extent of the claims, and consistently throughout all the discussions declined to indicate the amount of the claim asserted against any company or the total amount of claims asserted against all companies in this connection, and further stated that they were not prepared at this stage to discuss settlement, but would only discuss possible alternatives to the legislation, which alternatives they insisted must preserve for them a position identical to that which the passage of the legislation would give them.

In order to appreciate the significance of the attitude of the Treasury, it is necessary to consider what the effect of the legislation would be. The Canadian distilleries have American-type whiskies to a total of approximately 16,000,000 gallons, which are carried on the books of the companies at approximately 50 cents per gallon. These whiskies, if imported into the United States, become immediately subject to a customs duty of $2.50 per gallon and an excise tax of $2.00 per gallon, so that, apart from any question of profit to the Canadian company or any additional expense for selling or

moving

moving the liquors, the bald cost of a gallon of whiskey when imported into the United States is $5.00. It was indicated by the Treasury Department that they considered a fair market value in the United States, including taxes, to be approximately $6.00 per gallon, and that, in the event of security being furnished in accordance with the terms of the legislation, that would be the figure at which each gallon of whiskey would be valued. Obviously, the result is that a Canadian company, required, under penalty of embargo, to give security in pursuance of the legislation, would be obliged to add to the 50 cents, representing the distillery cost of its product, another $5.50, either in cash or by way of collateral given to a security company, thus reducing its fixed asset position by the book value of the whiskey (50 cents) and its working capital position by $5.50 per gallon, to say nothing of the outlay necessary to sell and ship the whiskey. This situation would, as was demonstrated in the discussions with the Treasury, be impossible for any Canadian company. So that it seems quite apparent that, whether the legislation pass or not, if its being dropped involves the substitution of an agreement giving the Treasury equivalent security, the agreement itself is impossible of performance, and in either event the result must inevitably be that Canadian whiskies could not be imported into the United States.

It was urged on behalf of the distillery companies that the

the legislation sought by the Treasury would not achieve either of the objects which are urged as the reasons for its adoption, because (a) the legislation of itself confers no jurisdiction upon the United States Courts which they do not now possess, and (b) the provisions with respect to security are so rigorous and so unreasonable as to be prohibitive, as shown above.

It was suggested that the legislation, or any agreement in substitution for it, be not proceeded with, and that the individual companies sit down with Treasury officials and discuss the nature and quantum of the claims alleged to exist, with a view to reaching some solution, and that, if this were agreeable, the companies would consider undertaking in the meantime (1) not to increase their importations into the United States save in the normal operation of their business, nor (2) to adopt any measures which would have the effect of disposing of their assets in such a way as to prejudicially affect the present position of the Treasury Department with regard to ultimate collection of any alleged claims. It was pointed out that during the nine months subsequent to the introduction of this legislation in July last, the records of the Treasury Department will show that importations of Canadian whiskies from the companies represented were those which would follow the normal course of their operations, and disclosed no attempt to dispose of assets so as to put them

them beyond reach of an execution creditor.

Here again the Treasury officials showed themselves either unable or unwilling to disclose the amounts of the claims which they alleged to exist, and under those circumstances it became obvious that it was impossible to discuss any question of alternative security, because no company could, having regard to the most elementary business principles, commit itself to a general formula to provide security in an amount not only unadjudicated, but undisclosed, and, so far as the companies are concerned, indefinite and incapable of ascertainment by them. The Treasury Department argued that at the time of the institution of the proceedings the amount would be disclosed, and that the passage of the legislation or the making of the agreement imposed no insuperable barrier to discussions looking toward settlement, and further intimated that they considered that the business of exporting the Canadian whiskies to the United States was of such value to the companies concerned that if legislation existed which would enable the Treasury Department to prevent importation, settlement could be more readily achieved. Such an attitude, of course, completely disregards the international aspect of the situation and takes no allowance or concession to the representations made by the Canadian Government as to the objectionable nature of the legislation.

During these discussions it was pointed out to the officials

officials of the Treasury Department that the only asset of the Canadian companies from which they might expect to make collection of any claims such as are alleged to exist consisted of American-type whiskies now stored in Canada, and that unless these whiskies could be moved into the United States the United States Treasury would lose not only any possible chance of collecting the claims now under discussion, but would also suffer a very substantial loss of revenue. The 16,000,000 gallons now in Canada, if moved into the United States, would pay to the Treasury, first, as duty, $2.50 per gallon, or $40,000,000 and would in addition pay to the Treasury $2.00 per gallon excise, or $32,000,000, making a total of $72,000,000. The imposition of the embargo, which must inevitably be the result of the legislation or of any agreement conferring similar advantages to the Treasury, would certainly result in a diminution of United States revenues to the extent of the duties, namely $40,000,000 and to the further amount of the excise, unless American whiskey were manufactured and sold to the absolute equivalent.

Notwithstanding the fact that the Canadian distilleries have continually asserted that they are not aware of the existence of any valid claims against them, and have taken and still take strong exception to the form and character of the proposed legislation as being essentially discriminatory, they have indicated as these discussions a sincere desire

desire to reduce the alleged claims to some practical basis from which they might proceed to explore the possibility of solution by settlement or otherwise, and this they consider to be an evidence of good faith on their part. If this attitude is not acceptable, it would not seem to be an unfair conclusion that the Treasury officials are seeking, even though it be at the expense of their own revenues, to keep the Canadian whiskies out of the United States, contrary to the spirit of the Agreement recently arrived at between the United States and Canadian Governments, or are endeavoring to force settlement of claims, particulars of which they are unwilling to disclose, by methods which are, to say the least, confiscatory.

WASHINGTON, D.C. March 31st, 1936.

HMjr: you want to explain this thing to me so that I can understand it -

W. C. Taylor: All right, we'll let Bill Myers do it.

HMjr: All right

Bill Myers: Good morning, Henry.

HMjr: Hello, Bill, would you mind holding class for a few minutes?

M: I'd love to, if you're feeling all right.

HMjr: Oh, I'm felling all right - You may think I feel too well.

M: (Laughter)

HMjr: I still know how to say no.

M: All right

HMjr: Bill, this hundred and eighty million that you are proposing to call, how is that divided?

M: Among the banks?

HMjr: No, no - as to different issues - Is it all one issue?

M: Yes, I believe it is.

HMjr: You've got a hundred and eighty million of one thing?

M: A hundred and eighty-five million.

HMjr: Of one thing?

M: I believe that's right.

HMjr: Well, you ought to know. I thought it was different ones.

M: No, this is a hundred and eighty-five million of four and halves that have been callable since thirty-two.

HMjr: A hundred and eighty-five million of four and a halves?

M: Yes, we passed them over last May because we took the four and three quarters -

HMjr: Yes

M: We passed them over in November as you know because of the European situation.

HMjr: Yes

M: And we can - the market is very good. It looks as though there would be a very high percentage of conversion.

HMjr: Well, now, Bill, there's a hundred and eighty-five four and a halves -

M: That's right.

HMjr: These - are they only called once a year?

M: Twice

HMjr: Twice a year - May first?

M: And November first

HMjr: And November first?

M: Yes

HMjr: Well, just a minute, I'm making notes. May first -- November first - - Now, this - you've got a group of underwriters haven't you?

M: Yes

HMjr: Now, they again don't guarantee to take the full amount, do they?

M: No

HMjr: They only take what they can sell?

M: Well, we - we call the whole issue -

HMjr: Yes

M: Then we call an offering for cash to take care of those that aren't converted. The cash subscription is of course - always has been very heavily over subscribed -

HMjr: How much do you offer for cash?

M: Well, we haven't gone into all the details because we wanted to check with you before having the bankers together.

HMjr: Yes

M: We expected to call a meeting of them in New York about Wednesday -

HMjr: Yes

M: And to call the bonds about Friday -

HMjr: Yes

M: - and make our offering on the sixth, a week from today.

HMjr: Yes

M: And presumably there would - they expect around eighty-five or ninety per cent conversion, which would mean a cash offering of - for allotment of around twenty-five or thirty million -

HMjr: I see.

M: - would be all that we would make.

HMjr: Now you're - you're talking about a three per cent?

M: That's right.

HMjr: And - a ten twenty?

M: Yes

HMjr: Yes

M: You see, it gives us freedom -

HMjr: I know.

M: And, the issues we put out last January are now selling at par and an eighth bids and it looks, with the bond market looking good, it looks as though we might get about ninety-nine and a half -

HMjr: You mean that's what you'd get?

M: Well, that's what they'd sell for and the underwriting fee is a half a point. So we'd net ninety-nine.

HMjr: Oh -

M: Which is better than we've done at any time.

HMjr: Yes. Well now, this other thing that you wrote me about - wanting ten or twenty million - that's in cash - that's entirely a separate -

M: That's a wholly separate thing.

HMjr: And that isn't up now?

M: Well, here's the situation. It doesn't have to be up now. We have forty million cash -

HMjr: I - you've got forty million?

M: And the market will look so good that if it's O. K. with you we thought we would sell a million or two a day until we got fifteen or twenty million more -

HMjr: Well, Bill, I just raise this point - I don't see why you should be paying two and three quarters per cent interest on fifty million dollars when that really is five months supply of money.

M: No, we -

HMjr: My thought is if you always had three months supply on hand is plenty.

M: Well, we were thinking of the June operations in part. If we could sell fifteen million -

HMjr: Yes

M: It would take us through July first with - with about twenty million on hand July first.

HMjr: Yes

M: Now, if you want to go below twenty million -

HMjr: Well, let's leave it this way, you wouldn't want to do it this week?

M: No - no

HMjr: What?

M: No -

HMjr: Well, why don't you let that rest until I come back next Monday?

M: Fine -

HMjr: I mean, so that we -

M: Sure

HMjr: Is that all right?

M: Yes, absolutely.

HMjr: I mean, I just would like to concentrate on this other thing of yours.

M: Correct

HMjr: Now, let me throw this idea at you. The way I feel these days, I'd much rather give the market a little bit less than they expect and a little bit sweeter, that's the way I feel.

M: Yes

HMjr: I'd like you to think this thing over for twenty-four hours and then you could talk to me again.

M: Yes

HMjr: The idea of the possibility of calling, say a hundred million of this, see?

M: Yes

HMjr: Not the whole - call half of it.

M: Yes

HMjr: And then do the other half in November. Now, the that I get - the time that the other Farm Credit thing didn't go well - they didn't tell us at the time - but there have been four separate issues of private concerns which is what they call "sticky" - have not gone well.

M: Yes

HMjr: Just ahead of that, see?

M: Yes

HMjr: They didn't tell me that until afterwards.

M: Yes

HMjr: Then they said yours would have been fifth.

M: Well, there's - there's another thing in that too, they didn't like the bidding -

HMjr: I know -

M: And it was -

HMjr: I know -

M: It was a mortgage corporation issue.

HMjr: I've got - I've got two propositions that I'd like you to think about. One is say to offer about half of say a hundred million -

M: Yes

HMjr: The other thing - you have - and I don't even know whether I want to do this. Is Bell present?

M: Yes

HMjr: All right. You have something like fifty to seventy-five million worth of Governments - in your Farm Mortgage Corporation, haven't you? -- U. S. Governments?

M: In - not in the Mortgage Corporation. But we have some in various of the corporations.

HMjr: Yes - well, supposing you offered the whole hundred and eighty-five and it didn't go well would you people be willing to say that you'd sell your Governments to buy up the difference of these? I mean I don't expect you to answer me over the phone -

M: Yes

HMjr: - to a certain amount, in other words, I - would you be willing to underwrite to the Treasury - agreement between your agency and the Treasury that "if this thing fell short, well, we'll sell fifty million

worth of Governments and buy fifty million of these new threes" - ?

M: Yes

HMjr: In other words, here's the thing, at this time -

M: Yes

HMjr: - I can't afford, as the present Secretary of the Treasury, to have even the slightest possibility of failure anywhere along the line.

M: Yes, yes -

HMjr: Because we all get blamed for it, you understand?

M: Yes

HMjr: Now, the fact is, that this Consolidated Gas did not go well. -- The Shell Union thing did not go well.

M: Yes

HMjr: Now I think, on the third issue, I forget what it is, but I know the Consolidated Gas did not go well -- the Shell Union didn't go well -- We've got a very very serious thing abroad -

M: Yes

HMjr: And - the time - it isn't as propitious as it was thirty days ago. On the other hand I realize it's good business -- it's important to you to make your conversion and I want to see you do it -

M: Yes

HMjr: But I want it a thousand per cent successful.

M: Yes, so do I.

HMjr: So - but I'd like you to think over and then be back in this office twenty-four hours from now -

M: Yes

HMjr: Talk it over with Taylor - two propositions: One the idea of offering say a hundred million and the other the possibility of your organization saying to the Treasury, "Well, if this thing falls short up to fifty

million dollars we'll take those threes.

M: Of course, I think we could do that through the Mortgage Corporation.

HMjr: Well, I mean, in other words, you'd be underwriting yourself -

M: Yes

HMjr: - towards the Treasury.

M: Yes, we can't afford to pay the syndicate to underwrite it.

HMjr: No, no, no, no - No, I -

M: But we can handle it

HMjr: pay them anything.

M: But I think the best way to underwrite it is to sweeten it a little as you suggest so there won't be any doubt.

HMjr: No, but you - if you'd say to me, 'Now if this thing - if we did the whole amount or even half the amount and whatever didn't go up to so much we'll take and sell our Governments" -

M: Yes

HMjr: Now, I don't think that's an unfair proposition.

M: No!- I don't either.

HMjr: Now, you could also come back at me - I'm perfectly willing. Let me know how much the Treasury in its various investment accounts owns of these four and a half.

M: They own practically none of them.

HMjr: Well, I'm sorry. I was going to say,"I'll play ball with you."-

M: Yes

HMjr: "And I'll be willing to hold back and play second fiddle and hold ours until it's cleared up" -

M: Yes - There might be - if you're investing some funds there might be a few that you could put into this issue -?

HMjr: Well, wouldn't this new issue be not guaranteed?

M: That's right, not guaranteed.

HMjr: Then Postal Savings can't buy it.

M: All right.

HMjr: I mean, if it's a guaranteed issue Postal Savings could.

M: Yes, yes -

HMjr: But if you'd think that over and talk it over with Bell and with Wayne Taylor and then let me talk to you again in twenty-four hours - ?

M: I will do it. I'll be here then tomorrow morning.

HMjr: And - I wish, if you didn't mind, that you'd sort of carry Burgess along on this thing and keep him posted -

M: I will.

HMjr: And then if Taylor would ask him - after Burgess has thought it over and talked to the market I wish that Burgess would send me a memo tonight. He could send me - they could send me a code message on the wireless and I could read it before I speak to you in the morning.

M: All right.

HMjr: I'd like to have - to know what he thinks about it.

M: All right.

HMjr: Now what - does what I say sound perfectly fair?

M: Yes!

HMjr: See?

M: I don't want to be a nincompoop in your lap. I think that there hasn't been one of the Land Bank issues

that has even almost gone flat.

HMjr: Yes

M: And some of them have been in tough situations when we broke the ice, you know, in the Spring of thirty-four?

HMjr: Yes

M: And I think we can handle it so that it won't cause the slightest embarrassment to the Treasury and if we can't I don't want to do it!

HMjr: Yes, well, then neither of us - we're both thinking absolutely the same.

M: You bet.

HMjr: Well, Bill, if - if you could do that, let me talk to you in twenty-four - well, let me talk to you, you'd better make it ten o'clock tomorrow.

M: All right.

HMjr: See?

M: Yes

HMjr: About -

M: I'll come over here and talk -

HMjr: Yes, at ten o'clock tomorrow.

M: All right, Henry.

HMjr: All right.

M: I hope you're having a little chance to relax.

HMjr: Yes, I - this is really the - I have practically talked no business since I've been down here.

M: Fine

HMjr: But, this is too big, I mean, after all, a hundred and eighty-five million still looks like real money to me.

M: Oh, well, that's just cigarette money to you.

HMjr: No, it isn't.

M: O. K. Do you want to talk to Wayne again?

HMjr: If you don't mind.

M: O. K.

W. C. Taylor: We'll check on that with Burgess the last thing this evening and then

HMjr: - what he thinks and then let them put it on a code message so I'll get it tonight.

T: All right.

HMjr: I wouldn't get the mail in time to read it.

T: All right, we'll tell Jack and send it down.

HMjr: Yes, but I'd like to have him carried along on this thing -

T: Yes -

HMjr: Let him check in New York - Do you think what I said is perfectly fair?

T: Absolutely!

HMjr: What?

T: Absolutely!

HMjr: All right.

T: I think that- I think of the two, just off hand, why to do the full amount and have a - and have a cushion there is probably the best thing to do.

HMjr: Well -

T: As long as it's cushioned.

HMjr: Well, I didn't understand it before and I'm making the suggestion now -

T: Oh, yes

HMjr: And you fellows can think this over. I may be unnecessarily concerned, but I - we can't - we can't afford to have anything but a thousand per cent successes.

T: No, absolutely -

HMjr: Yes

T: Now, that - we've got three distinguished Canadians who are arriving in town today -

HMjr: Yes

T: And there'll be - we'll have a meeting over here at four o'clock.

HMjr: Yes

T: They got on the train immediately.

HMjr: Oh - and whose office do they meet in?

T: Well, I thought I'd have them meet in mine.

HMjr: I see. Who is going to be there?

T: Why, I haven't been able to get a hold of or talk to Oliphant yet this morning. There are going to be these three Canadians plus their Chargé plus probably Judge Moore.

HMjr: I see.

T: On account of their Charge being present why apparently the State Department has to be represented too.

HMjr: I'd like Mrs. Klotz to be there if you don't mind.

T: All right, that would be fine.

HMjr: Right - and - because she sat in on all of these and it gives me a continued story. And - anything else?

T: We've got a couple of reports on the - you know these bills we're setting up a commission for debt - looking over the War Debt situation again?

HMjr: Yes

T: I'm not so crazy about these - the reports that we're putting in on those bills.

HMjr: Yes

T: I haven't talked to whoever it is I want to talk to about it but I think it's a little dynamite to word it the way that it is being worded.

HMjr: I see. Well - there's nothing - not knowing anything about it I can't give you advice.

T: No, but I think we ought to watch our step on that a little.

HMjr: All right. Is Dan there?

T: Yes, Dan's here.

HMjr: Please -

T: Herbert wants to talk to you a minute.

HMjr: Who?

T: Herbert Gaston

HMjr: Right

Herbert Gaston: Henry, I was - wanted to go to that hearing this morning - Guy Helvering is going to deliver his speech -

HMjr: Good

G: - at ten o'clock.

HMjr: Good

G: And so I wanted to get away. Anything in particular you wanted to say?

HMjr: No, was there anything more?

G: Why, the Wall Street Journal reports that despite the fact that strictest injunctions were given that this should be confidential it leaked out from Congressional Sources.

HMjr: They're the only other paper that ran it?

G: That's the only one I've seen, yes.

HMjr: Yes

G: Yes

HMjr: Yes, well that's

G: Yes

HMjr: All right, Herbert.

G: All right, I'll put Dan on -

HMjr: Please -

Dan Bell: Good morning -

HMjr: Hello, Dan

B: I've nothing in particular - everything's sort of quiet.

HMjr: You agree with me on what I told Myers?

B: Yes

HMjr: What?

B: That's all right, that's fine. And I think it will work out. If he has to sell his Governments of course we can buy a substantial amount of them for Postal Savings in Federal Deposit.

HMjr: Has Myers gone?

B: No, he's still here. I've talked to Burgess a couple of times about it and he has it definitely in mind. He thinks the market, if there is no change, will take it nicely on the basis of three and along the figures that Bill talked to you about, ninety-nine and ninety-nine and a half, and -

HMjr: Well, Burgess has a way of finding out how many of these recent issues are still on the dealers' shelves, you know?

B: Yes, yes -

HMjr: I mean, how much Shell Union they've got left -

B: Oh, sure - sure -

HMjr: How much Consolidated Gas they've got left -

B: Of course, these things here are refunding and not cash -

HMjr: I know - I know -

B: Except part of it. But Burgess is studying it.

HMjr: I know Burgess and I've seen these things go sour when everything looks beautiful at the time that I worry the most.

B: Well, I don't blame you.

HMjr: And I've seen - everybody says everything is lovely, then something comes along over night and the bottom falls out.

B: Well, I'm sure you can't plan for that.

HMjr: I - it's happened to me now two or three times in two years -

B: Yes -

HMjr: And I don't want it to happen now for everybody's sake.

B: There's a little bit of criticism in the Hill -

HMjr: Yes

B: - on this particular issue because we didn't call it last year and save that extra interest.

HMjr: I see.

B: I had some Congressmen in the other day and they were all arguing for this Land Bank production and interest rate -

HMjr: I see.

B: And also trying to forestall the Frazier-Lemke Bill -

HMjr: I see.

B: And they were a little critical of the Administration in not taking advantage of the low interest rates last year in refunding this particular issue.

HMjr: Well, if that's - if that's true then why doesn't Bill get out something a little bit shorter and go in for two and three quarters?

B: Well, of course he's got to fit this in, as far as he can, to his Mortgage program.

B: See, he's got a Mortgage -

HMjr: it looks a lot better than three per cent.

B: Yes

HMjr: I don't know just when his issues fall due - whether he's got anything coming due in eight or nine years.

B: Well, of course these - they're all set out - a graduate law, coming due every two years -

HMjr: Yes

B: He's got quite a few issues out. He's still got quite a few fours and four and a quarters outstanding we'll have to meet sooner or later.

HMjr: Yes

B: - along the line.

HMjr: Well, think it over and I can talk to him again at ten o'clock tomorrow.

B: All right.

HMjr: Tell him - hello?

B: Yes

HMjr: Tell him a quarter of ten.

B: A quarter of ten?

HMjr: Yes

B: All right.

HMjr: A quarter of ten.

B: Feeling all right?

HMjr: Yes, I'm feeling a little better, thank you.

B: Good weather down there now?

HMjr: It has been good. It's a little overcast today.

B: Yes - we had a grand day yesterday and another one today - just like spring.

HMjr: Fine

B: All right

HMjr: Goodbye

B: Do you want to speak to Mrs. Klotz any more?

HMjr: Please