

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 1, 1937To Chairman Eccles

Subject: _____

From Malcolm H. Bryan*Mr. H. H. B.*

In accordance with your desire to be kept abreast of the discussions of taxes to repel foreign capital and gold, I am reporting conversations with the Treasury staff that occupied all of yesterday (Wednesday, June 30).

1. Progress has been made on a good many points. But the staff is handicapped in going further because there is in the group no clear definition of controlling objectives.

The chief fact before us is that taxes must be heavy enough to repel in considerable measure the flow of capital and gold into the United States and to impede the transfer of present bank balances into the securities markets. If this consideration could control a decision, it is probable that we could now quickly reach an agreement to recommend (1) an increase in the present 10 per cent rate on fixed items of income in order to deter investment capital, and (2) a speculative profits tax on stock certificates in order to deter the inflow of speculative capital.

2. Our problem appears to defy solution when the question of discrimination against foreigners is brought into the discussion. Repeated exploration of the subject seems to have convinced everyone who has followed it closely that we can only deal effectively with the foreigner by flat rates (of which our present tax is an example). But

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no flat-rate tax is entirely equitable on the small foreign security owner in contrast with the large security owner; and there seems to be no real basis for saying just what rate on foreigners would be equitable in comparison with the variety of domestic graduated rates on Americans. About the only point on which there is clear assurance in this connection is that our present flat rate must be raised considerably above its existing 10 per cent level in order to make it of much use in keeping capital and gold out of this country.

3. At the morning session of the staff yesterday, Mr. Segrest, of the Bureau of Internal Revenue, reported a plan for withholding 22 per cent from a foreigner's interest and dividends and other items of fixed income in the United States, with the foreigner allowed to file returns and reduce his tax, on the basis of a return, to a minimum of 10 per cent. Mr. Segrest was himself very critical of the proposal, and Mr. Zucker expressed serious doubts regarding its desirability. The following points were made concerning it.

(a) The administrative load on the Bureau would be large and especially troublesome in trying to deal with a type of return that is unreliable and made by a taxpayer whose person and, in many instances, whose property is beyond the jurisdiction of the United States.

(b) The plan would not impel foreigners to file returns when their fixed incomes from American sources were small in comparison to capital gains, unless they had losses to offset their gains.

- (c) The plan would run athwart of laws in many foreign countries that prohibit brokers in those countries from revealing their clients.
- (d) The foreigner would realize his capital gain abroad, where the United States would be practically powerless to check up on his return.
- (e) The tendency to realize capital gains abroad might have the undesirable effect of developing foreign markets in American securities and facilities for American trading abroad.
- (f) The American administration would be powerless to prevent foreigners from splitting their income by a multitude of devices into many small parts in order to secure the advantages of the lowest effective American rate.
- (g) If the returns were permitted on the same basis as Americans, an advantage would be created for the foreigner to hold his capital here until he could obtain the lower capital gains rates in accordance with the length of time property is held. If this procedure were not allowed for foreigners, we would still have a discrimination.

All in all, the conclusion seems to be that, as Mr. Segrest put it, a provision for foreign filing of returns would be simply "a gesture" and in practice the rate on foreigners would be whatever minimum rate is provided for fixed items of income--under the proposal 10 per cent, which is no increase over the present law.

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4. Both yesterday morning and yesterday afternoon a great deal of attention was devoted to a speculative profits tax to be levied on the gain from each stock certificate from the time it passes into a foreign hand to the time it is resold by a foreigner to an American. The whole procedure of applying this tax was canvassed. Mr. Francis Greene, of the Securities and Exchange Commission, has expressed himself as favoring this tax. Mr. Segrest, of the Bureau, who went over it with us, has expressed his opinion that it is fairly easily and effectively administrable without substantial addition to the present administrative procedure of the Bureau. Mr. Zucker, of the Treasury, has expressed himself as feeling that this tax is the most promising of the proposals for effecting a deterrent against speculative capital.