

May 27, 1936.

My dear Mr. President:

Enclosed is a brief memorandum on the Senate Finance Committee's tax proposals. I feel that they are so unsatisfactory from every standpoint, economically, socially and politically, and fail so completely to meet the objectives which you have enunciated that I would be remiss in discharging the duties of this office and in my loyalty to you if I failed to record my opinion as to the injurious effects which enactment of such proposals would have on business, banking and your entire recovery program.

Accordingly, I am taking the liberty of burdening you with this necessarily short statement of objections to the Senate Committee's proposals.

Respectfully,

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

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OBJECTIONS TO THE SENATE COMMITTEE'S TAX PROPOSALS

Enactment of the Senate Committee's tax proposals would, (1) penalize small corporations, (2) make the cost of the corporate form of enterprise well-nigh prohibitive for small business men, (3) constitute a departure from the principle of taxing according to ability to pay, (4) permit wealthy stockholders to continue to evade their fair share of taxation, (5) favor rather than check the growth of un-economic bigness, (6) be ineffective in forcing more purchasing power into circulation.

The position of owners of small corporations would be adversely affected because the corporate income tax would be raised from 12½ percent to 18 percent, as compared with only a 3 percent increase for large corporations. If, owing to their lack of access to the capital markets, small corporations retained earnings for debt retirement purposes or for expansion, they would be subject to an additional tax of 7 percent, or 25 percent in all, as contrasted with 12½ percent now. If they distributed earnings as dividends, the owners would have to pay a 4 percent normal personal income tax, or 22 percent in all. Such a tax, besides being unjust, would practically deny the benefits of incorporation to thousands of small business men, would lessen competition and encourage the growth of large corporations.

The income of stockholders in corporations retaining earnings would be subject to 10 percent more in taxes than under existing law (increase from 15 to 18 percent in the corporation income tax plus 7 percent). This is very much less than the surtax rates that would

apply to the incomes of many wealthy stockholders if earnings were distributed in dividends, but very much more than stockholders with low incomes now pay. Consequently our tax system would be graduated downward rather than upward, contrary to the accepted principle of taxation in accordance with ability to pay.

Furthermore, the rate of 7 percent applicable to undistributed earnings is so low that it would continue to be in the interest of wealthy stockholders to leave earnings undistributed with corporations. Since dividends would be subject to the 4 percent normal tax, the additional penalty upon retaining earnings would be only 3 percent, as against much higher surtaxes that would have to be paid if the income were distributed. This means that nothing would have been accomplished in closing up the loophole through which the wealthy evade surtax rates. Consequently there would be no impetus to the disbursement of accumulating idle corporate balances, to the flow of purchasing power, or to the recovery movement.

In order to overcome just such objections I previously proposed: (1) retention of the present corporate tax structure, (2) exemption of some \$15,000 to relieve small corporations which compose 90 percent of the total, (3) a rate of 8 percent on earnings held back to meet debt and statutory obligations, (4) a sufficiently high rate on undistributed earnings to induce corporations to pay them out to stockholders so that proper taxation would not be escaped.

May 27, 1936.

My dear Mr. Secretary:

Enclosed is a copy of a brief memorandum which I have sent to the President. It is self-explanatory and accords with what you and I have previously discussed.

Sincerely yours,

The Honorable
The Secretary of the Treasury,
Washington, D. C.

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