

Form F. R. 511

TO _____

FROM _____

REMARKS:

This is memo from Randolph Paul, which he wanted you to have this morning.

CHAIRMAN'S OFFICE



At a Treasury press conference held on January 26, 1942, a question was asked as to whether the Treasury had "any intention of indirectly reaching some of the partially exempt Federal securities by lowering the normal tax." The Assistant Secretary of the Treasury replied: "We have not considered lowering the normal tax on individuals or corporations. On the other hand, we are opposed to any increase in the normal tax, and we think that any increases the Congress considers should be increases in surtaxes, rather than in normal taxes. The reason why we are not considering a reduction in the normal taxes is, as the Secretary said, we do not wish to attempt to do by indirection what we think we cannot openly accomplish directly." In response to a question whether it was intended to resort "to the old Glass scheme of using tax-exempt income as a base to put taxable income in a higher bracket," the Secretary of the Treasury said: "I think we have gone around the thing pretty much. I said I am opposed - let me go over it once more. I recognize a contract exists between the Federal Government and the men or women who have bought our securities, and we don't propose by direction or indirection to tax them on this income, as long as these issues are outstanding."

The Treasury's statement was intended to make clear that it would fully respect the contractual provisions of its partially exempt bonds now outstanding in the approximate amount of \$50 billion. Such bonds have not been issued since the Public Debt Act of 1941 making all subsequent issues fully taxable. It was intended to state

a policy that no attempt would be made to impair the exemption accorded to these outstanding bonds by direct means, by the so-called "Glass" plan, or by the expedient of reducing the normal tax.

Unfortunately, some confusion has arisen with respect to an entirely different question. At the present time persons having both taxable earnings and tax-exempt interest have an advantage, as compared with other taxpayers, in that they are permitted to reduce their taxable earnings by the expense incurred in connection with the production of their tax-exempt interest. The privilege of deducting such expenses from taxable earnings is entirely a matter of legislative grace and has no bearing on the contractual obligation of the Federal Government not to impose taxes on tax-exempt interest. Quite to the contrary, the privilege constitutes a loophole in the statute which has long been apparent and has permitted certain taxable earnings to avoid their fair share of the tax burden.

Since banks are large holders of Federal partially tax-exempt securities, members of the Treasury's staff have had under discussion with representatives of the banking profession a method of charging against taxable earnings the expenses of banks which are a proper deduction from earnings and withdrawing the privilege of deducting from taxable earnings the expenses properly applicable to tax-exempt interest. Suggestions have been made for a formula to accomplish this result. No formula of allocation has yet been finally agreed upon, but it is hoped that a generally acceptable one may be devised.