

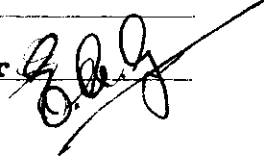
BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 21, 1936

To Chairman Eccles

Subject: _____

From Mr. Goldenweiser 

G P O 16-352

Attached is a brief statement on a proposed tax on undistributed corporate earnings, also a one-page statement on a proposal to require joint income tax returns for husbands and wives. While the latter is not fundamental, but purely technical, it appears to be an easy way to raise about \$150,000,000, largely from persons in the upper income brackets.

February 21, 1936

A TAX ON UNDISTRIBUTED CORPORATE EARNINGS

It is clear from recent developments that it will not be possible to balance the budget completely for several years. We are going to continue to have deficits. Broadly speaking, this is as it should be since, until business has resumed full operation, Government deficits are a necessary compensatory factor in the nation's economy.

It is imperative to continue to spend, though in gradually reduced amounts, from dictates of humanity and common decency, both because the unemployed must be given jobs, and because suffering must not be permitted. And it is necessary to continue to spend from a cold-blooded, hard-boiled point of view as well, in order to keep up the flow of money from public sources, until private money has regained a normal level of activity.

For psychological, political, and economic reasons, however, it is desirable to have the deficits decrease from year to year and a gradual approach to a balanced budget should be clearly envisaged. This should be accomplished in the immediate future, however, through additional revenues, rather than through decreased expenditures.

One source of revenue, which could be tapped to advantage, would be a tax on the undistributed earnings of ~~all~~ corporations. Among the advantages of such a tax would be that in many cases it would transfer income from corporations, which pay a relatively low income tax, to recipients of large personal incomes in the higher income brackets, who would pay large surtaxes.

Another important advantage of such a tax would be that it would diminish the power of the directors of a corporation, who may represent a small proportion of its stock, to dictate its financial policy without reference to the wishes of stockholders, who are the proprietors. This oligarchy of insiders has been a cause of many abuses and much injustice to investors, and particularly small investors.

If a corporation is required under penalty of a heavy tax to distribute all its earnings to the stockholders, it will have to receive the consent of stockholders for any new enterprise or program that the directors may wish to undertake. Whereas, if earnings are permitted to accumulate, the directors may embark upon a large undertaking without reference to the wishes or the interests of stockholders.

The proposed tax would also exert an influence against the concentration of control and the encouragement of bigness from which our corporate organizations and our economic life have suffered. It would prevent the accumulation of funds in the hands of corporations that enables them to expand continuously without being checked by the judgment of investors. It would also exert an influence against the growth of inter-corporate ownership and inter-corporate relationships which have been a source of vast abuse and much evasion of tax and other laws. The acquisition by one company of stocks of another would not be feasible without specific authorization by the stockholders.

The tax proposed would, therefore, be advantageous from the point of view of revenue; it would be good economic policy in general, and it would also be good social policy in that it would be a factor toward economic democracy and away from plutocracy.

The appropriateness of such a tax at this time is particularly apparent, because it is evident that a large part of the money spent by the Government for relief and for public works has, through one channel or another, found its way into the hands of corporations that are not inclined to spend the money for expansion or improvement, but are holding it idle for future use. Corporate reports show that many large corporations emerged from the depression with their debt structure considerably lightened and their cash holdings unimpaired or substantially increased. This accumulation of idle funds in the hands of large corporations stops the productive flow of money, which is essential for normal business, and is an important reason why the great increase of bank deposits, or money, brought about by Government borrowing and spending has not been reflected in a corresponding growth in business. A part of the deposits has been frozen and their velocity has been low. The money, after a short business life in making one or two payments and creating a profit for those who received it, has come to rest as a hoard in the hands of large corporations where it performs no further useful function and contributes nothing to recovery. To extract some of this money from these hoards, to put it into circulation by distributing it to the stockholders, and to prevent future accumulations, would not only be sound long-time economic policy but might do a great deal to hasten economic recovery.

An outline of the proposed tax is attached.

OUTLINE OF PROPOSED SURTAX ON UNDISTRIBUTED EARNINGS
OF ALL CORPORATIONS

Corporations subject to tax: any corporation with undistributed net
income determined as follows:

Statutory net income

Add: dividends received from domestic corporations

Deduct: (1) Federal income and excess profits taxes paid

(2) Cash dividends paid

(3) Amounts used to reduce indebtedness incurred
prior to January 1, 1935 - provided such
amounts are reasonable and reductions take
place in maturing floating debt or in matur-
ing or callable funded debt

Rate of tax - a flat rate, say 30 percent, or graduated rates

Date tax effective: on earnings for 1935 undistributed on December
31, 1936; tax returns and full or first quarterly payment due
March 15, 1937.

This tax would replace two existing surtaxes on undistributed earn-
ings of corporations: (1) on corporations organized or used for
the purpose of evading surtaxes, and (2) on personal holding
companies receiving most of their income from interest, dividends,
and gains from sale of securities

A PROPOSAL TO REQUIRE JOINT INCOME TAX RETURNS FOR ALL HUSBANDS
AND WIVES

If husbands and wives were all required to file joint returns, about \$150,000,000 of additional revenue would be raised during the calendar year 1937 at the tax rates now in effect. The additional revenue would come almost entirely from individuals who reported incomes for 1934 in excess of \$10,000. About \$90,000,000 of the additional revenue would come from individuals who had net incomes of \$50,000 and over for 1934 and the remainder of the revenue, except about \$15,000,000, would come from individuals with net incomes from \$10,000 to \$50,000.

This increase in revenue would not require an upward revision in the normal and surtax rates applied to individual incomes nor a change in the personal exemption. It would merely require an appropriate change in the law affecting the administration of returns, that is elimination of the privilege now given husbands and wives of filing separate returns.

From the point of view of ability to pay taxes, there is no reason why a man and his wife should not pay an income tax determined by their joint income. The ability of married individuals to pay taxes depends on the combined net income rather than on the fact that income may come from sources belonging legally to two individuals.

It may be suggested that such a revision in the income tax law would cause hardship in cases where separate establishments are maintained by husband and wife. In so far as this criterion has a justifiable bearing on the ability to pay income taxes, it might be met by broadening the provisions for personal exemptions applying to a "head of a family". The law now includes a personal exemption of \$2,500 for an individual who actually supports or maintains in one household one or more individuals closely related to him. This could be extended to provide a larger exemption, not more than \$5,000, in the case of separate establishments maintained by husbands and wives.

To raise additional revenue by means of this proposed additional charge would impose little restraining effect on recovery since it would affect mainly the wealthy whose incomes, at the present time, are not all spent on consumers' goods or the making of producers' goods. To cut down savings at the present time, in other words, is no impediment to recovery since there is a superabundance of idle funds seeking investment.

Thus there is much to be said for this proposal from the point of view of recovery, of yield, of equity and of popularity.

February 21, 1936.