

March 24, 1936.

APPENDIX ON DEPRESSION RESERVES

A firm stand should be made against exemptions for "depression reserves". As much publicity as possible should be given to the fact that the so-called depression reserves were in actual fact not availed of to any extent in the worst depression on record. The holdings of cash and tax-exempt securities reported in the income tax returns of non-financial corporations declined from December 1929 to December 1932 from \$10,859,000,000 to \$9,070,000,000, or by only \$1,789,000,000, while the reported holdings of other investments increased \$5,594,000,000. The surplus of these corporations decreased by nearly \$15,000,000,000, but this was due to charge-offs rather than out-of-pocket disbursements. It should be pointed out that corporations in general have more cash now than they have ever had in the past and that if they feel they need still more there is nothing to prevent them from issuing new stock for this purpose. [The whole argument for "depression reserves" is a smoke-screen to cover aversion to the payment of taxes and the weakening of despotic insider control that would be brought about by a prohibitive tax on undistributed earnings. The Administration should assume a vigorous offensive on this point and make the facts known.]

There is very little in the much-touted point that the retention of earnings in good times permits the payment of dividends in bad times, thus sustaining buying power. From 1925 to 1929 non-financial corporations reporting net income retained \$25 billions of earnings. From 1930 to

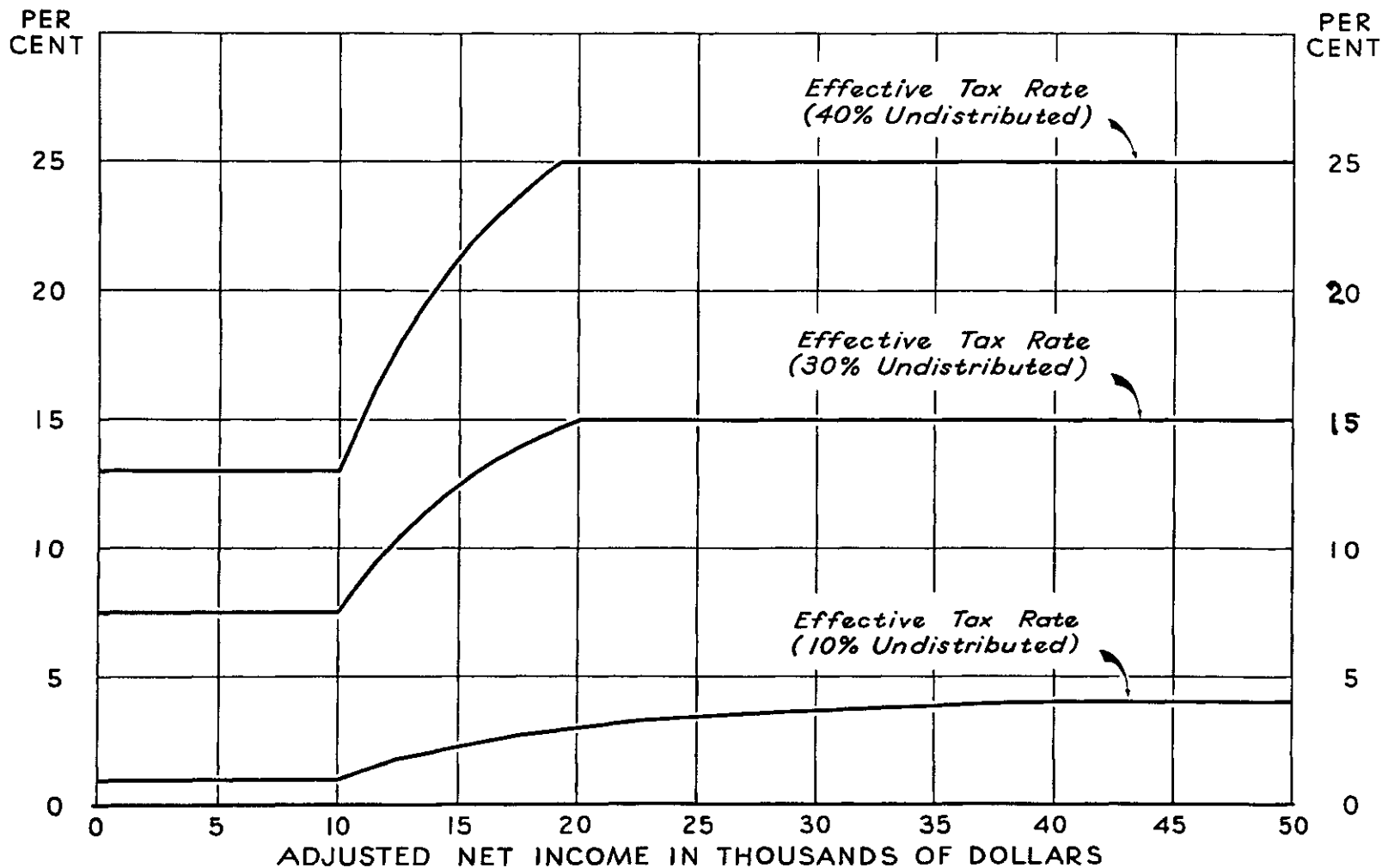
1935 the payment of unearned dividends amounted to only \$5,768,000,000. Moreover, during the same period non-financial corporations reporting net incomes withheld earnings amounting to \$1,054,000,000. This retention of earnings operated to counteract the increased buying power arising from the payment of unearned dividends. The net figure, therefore, was \$2,734,000,000. When this figure is compared with the sum of the declines in the national income from the 1929 level for the years 1930-35, --\$120 billions, -- it will be seen that the sustaining effects due to the payment of unearned dividends were of an exceedingly minor character.

[Another reason why no special exemption should be made for depression reserves is that under the proposed amendments corporations will have ample opportunity to put themselves in a position to avoid bankruptcy in a depression. Small corporations may dispose of their earnings as they see fit. Larger [corporations may not only retire their indebtedness but, in addition, raise cash through new stock issues. A corporation which enters a depression with little or no indebtedness, with a plant well kept up and conservatively valued by the deduction of more than adequate depreciation allowances from earnings in the past, with inventories and accounts receivable that can be turned into cash, is in a position to avoid bankruptcy and needs no great amount of previously accumulated cash. Not only can it strengthen its cash position by realizing on its inventories and accounts receivable and by not making further additions to inventories or extending further credit, but it can, in addition,

refrain from using its current depreciation allowances for improvements and replacements. These were the practices actually followed during the depression years. The fact that American non-financial corporations in the worst depression on record could pay out unearned dividends in excess of retained earnings, could retire debt, could sustain staggering losses, all with little impairment of their cash position, and actually increase their combined cash and investments, is clear evidence of the fact that their losses were attributable to write-offs rather than actual disbursements, and that they converted a substantial portion of their inventories, accounts receivable, and plant, into cash.

Read Finally, it may be pointed out that the surest way to have a depression is for everybody to prepare for one. Should corporations all build up large depression reserves in the form of cash, which, for the whole economy, is the one asset ultimately liquid, the resulting interruption of the monetary circulation would bring on a depression. If the monetary authorities sought to meet the situation by providing more and more cash to satisfy the needs of corporations, the situation would be fraught with danger. One could never be sure that when business became more active corporations might not entrench upon these reserves for further expansion and precipitate a boom. That, in fact, is one of the dangers of the present situation. Corporations have built up unusually large accumulations of cash, far out of line with their present requirements, in the past few years and these holdings will permit expansion later without recourse to the banks or the capital market.

PROPOSED TAX ON CORPORATE ADJUSTED NET INCOME BASED ON PERCENTAGE OF ADJUSTED NET INCOME UNDISTRIBUTED*



* As reported by Subcommittee of Committee on Ways and Means, March 26, 1936