MEMORANDUM RE: MODIFICATION OF UNDISTRIBUTED PROFITS TAX

Certain difficulties, particularly to small and medium sized corporations, are apparent in the present tax on undistributed profits. Normal and necessary expansion is made impossible through retaining part of earnings excepting at the prohibitive financing charge of upwards to 27%, which cost is in the form of the tax. The present promotion and underwriting mechanisms do not provide for reasonable financing for small corporations.

Under the present Act, the corporation has two options; one is to retain all or part of its earnings and pay a tax on it; the other is to pay out all of its earnings, transferring the tax liability to the stockholder.

Under the second alternative, the corporation can pay a stock dividend, thereby retaining its cash. However, in many situations, this is an impossible burden on large stockholders who must pay a high tax and who would have no cash with which to pay it.

A third alternative is suggested. A corporation has the option to invest its undistributed profits in a special issue of 25-year 1% government bonds. A corporation requiring additional cash for approved purposes such as additional working capital or plant expansion, could issue long-time notes secured by the government bonds. These notes could be sold to a commercial banks who would have the privilege of re-discounting with the Federal Reserve. The maturity of the notes not to be beyond the maturity date of the government bonds; the notes to be amortized in equal annual installments to maturity. The re-discount rate for this particular type of security could be sufficiently high to encourage strictly private financing where possible. The Federal Reserve to

have the right to deny re-discount privileges where the proceeds are to be used

for purposes outside of their regulations.   In times of over-expansion, Federal

Reserve could discontinue re-discount privileges ~~altogether~~ altogether.