TREASURY DEPARTMENT

WASHINGTON

July 17, 1942

Dear Marriner:

In our recent conversation you expressed some doubt as to how much effect corporate taxes affected inflation.

In this connection the distribution of dividends among individual income taxpayers, shown on Table 2 of the enclosed press release on 1940 Statistics of Income, is of interest. It is estimated that dividends paid by corporations in excess of dividends received were approximately $4,300 million. Of this amount, $3,400 million was reported on income tax returns filed from January through June 1941. More than one-third of such dividends were reported received by individual income tax return filers (including taxable fiduciaries) with net incomes under $5,000, and slightly less than half were received by individuals with net incomes under $10,000. Persons in these income groups, of course, spend the large bulk of their income for consumers goods.

I thought you would be interested in seeing these data.

Sincerely yours,

Randolph E. Paul
Assistant to the Secretary

Honorable Marriner S. Eccles,
Chairman, Board of Governors,
Federal Reserve System,
Washington, D. C.

July 23, 1942.

Mr. Randolph E. Paul,
Assistant to the Secretary,
Treasury Department,
Washington, D. C.

Dear Randolph:

Thank you for your letter of July 17 enclosing some figures on the distribution of dividend receipts by income groups. I noted with interest the large proportion of dividends reported on returns falling in the relatively low income groups.

As you are aware, there are a number of factors that complicate the interpretation of these figures. One of the most important is that the separate returns filed by the individual members of family groups are classified not according to the aggregate net income of the family, but according to the net income shown on the return. Separate returns filed by husbands and wives are merely one important instance of a much more general practice. Transfers of corporate stock from husband to wife, from wife to husband, from parents to children, and from children to parents raise relatively few legal and practical difficulties. We should expect it to be one of the most frequently used methods of distributing income for tax avoidance purposes. You have no doubt encountered many examples of the practice in your own experience. Thus there is reason to believe that a considerable share of the dividends reported on returns showing a net income of less than $10,000 is received by the wives, daughters, and other relatives of men in a considerably higher income group. In many of these instances the use of dividend income depends on aggregate income for the family group as a whole, not on the taxable income of its individual members.

Another complicating factor is the inclusion of the returns of taxable fiduciaries and their classification according to the net income taxable to the fiduciary. This is another reason why the figures do not represent with complete accuracy the distribution of income among individual households or family groups. Since the net income taxable to the fiduciary is in general merely the taxable income of the trust not distributed to beneficiaries, it is meaningless as a guide to the income level of beneficiaries and their patterns of expenditure. Moreover, a single grantor may set up a multiplicity of trusts for a multiplicity of individuals. In many of these cases the significant factor in determining how income will be used is the aggregate income received from all sources by the grantor and the several beneficiaries.

But after allowing for these qualifications, the figures do provide strong support for the view that the receipt of dividends gives rise to consumer expenditure. The figures also indicate, however, that the receipt of dividends generates a smaller volume of consumer expenditure than the receipt of most other forms of income. And viewed from the point of view of equity, the tables show that there are a very large number of corporate stockholders with relatively small incomes. It seems unfair to subject these taxpayers as stockholders to rates that we would never think of applying to them as individuals.

Yours sincerely,

M. S. Eccles,
Chairman.

WK:mgm