

THE
NORTHERN VALLEY NATIONAL BANK
TENAFLY, NEW JERSEY

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MEMBER OF
FEDERAL RESERVE SYSTEM
FEDERAL DEPOSIT
INSURANCE CORPORATION

December 9, 1947

Mr. Marriner S. Eccles,
Chairman, Federal Reserve System,
Washington, D.C.

Dear Sir:

By easing up the tax liability on income which is derived from United States Government Bonds in the forthcoming federal tax program, the following results may be partially attained:

- ✓ 1. Control of further inflation.
- ✓ 2. Support of Government Bonds in the face of rising interest rates.
3. The holding and continued buying of Government Bonds by individual investors.
4. The easing of the present tax burdens without over-stimulating consumption buying.
5. Resistance to Communistic doctrines.

For example, in the new tax bill:

- a. The first \$1,000. (or any part thereof) of income from any Government obligation to be tax free.
- b. The next \$4,000. of similar income to be taxed at not more than 25%.
- c. All additional income from Government Bonds to be taxed at not more than 50%.

Such modified exemptions would invite savings by all classes of citizens.

The larger demand for the long-term Government issues would sustain the market price of Government Bonds which now have to compete with tax-exempt issues.

Mr. Marriner S. Eccles

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Bonds might pass from the portfolios of banks and into private ownership.

The tax load would be lightened for all classes of citizens who have supported the Government credit in war-time.

It would help all classes of citizens who have savings accounts, building loan shares and life insurance policies.

Such tax exemptions on income from Government Bonds could be changed from time to time by subsequent Acts of Congress, as a means of controlling or stimulating prices and business volume.

The above suggested ratios are obviously only guess work. They would have to be studied to obtain full knowledge of their effect on diminished Federal revenues.

Very truly yours,



Herbert R. Johnson

HRJ/HM_-

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 15, 1947

To Mr. Morrill

Subject: Suggested reply to Mr. Herbert
R. Johnson's letter of December 9 to
Chairman Eccles.

From Miss Burr

The proposal, in brief, is that future tax legislation include specific exemptions from income tax for present holders of fully taxable Federal Government securities. Such a provision would be undesirable for the following reasons:

1. Such provisions would have practically no effect on inflationary forces, which result basically from an effective demand greater than the supply of goods and services. The effective demand, which is composed of savings, current income, or future credit, would be little affected, although there would probably be some changes in the distribution of income as a result of adjustments in the tax system, mentioned below, and of shifts in investments. The proposal would not affect the supply of goods and services.

2. The proposal would not reduce over-all tax burdens. Total interest payments of the Federal Government would not be changed by the proposal. To the extent that the exemption reduced receipts from one type of income, either higher income tax rates or adjustments in other taxes would be needed to provide the total revenue needed for the budget. ✓
x
✓

3. The proposal would not affect the trend of interest rates. During the recent rise on rates on long-term bonds, yields on fully tax-exempt State and local government obligations have risen, as well as those on taxable issues, both Federal bonds and private corporate bonds.

4. The termination of exemption from Federal income tax for future issues of Federal Government securities early in 1941 followed a long period during which successive secretaries of the Treasury had recommended that steps be taken to terminate the tax-exempt privileges of all Government securities. In 1940 the Secretary of the Treasury asked Congress to give consideration to a number of matters of public debt policy including the question whether the interest from future issues of Federal securities should be subject to income tax. These considerations resulted in the Public Debt Act of 1941 which became effective March 1, 1941 with respect to termination of tax exemption for new issues. It is to be hoped that this step, taken prior to the large volume of war financing, will be followed by appropriate action to subject the interest of State and local obligations to Federal income tax. A progressive income tax cannot be equitably administered if there exist large investment outlets which are tax-exempt. ✓

December 18, 1947.

Mr. Herbert R. Johnson, President,
The Northern Valley National Bank,
Tenafly, New Jersey.

Dear Mr. Johnson:


Your letter of December 9 interests me very much indeed and I would have acknowledged it sooner but for the extraordinarily heavy pressures under which I have been laboring in recent weeks.

I have given some thought to your suggestions and certainly think they merit very careful consideration. With that in mind, I have passed your letter along to our economics division, particularly to those who specialize in tax matters, and at the earliest opportunity I want to discuss the possibilities you suggest with them. I am leaving for the West at the end of this week for the holidays. On my return I will discuss the matter with our staff and let you know if they feel that it would be practicable to carry the matter further.

I appreciate your passing these proposals along to me.

Sincerely yours,

M. S. Eccles,
Chairman.

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