

Mr. Eccles

You might be  
interested in  
noting this memo  
from Rich Osbourne.

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# Office Correspondence

Date February 14, 1945

To Mr. Thurston  
From Richard A. Musgrave *RAM*

Subject: Blough and Purcell Memorandum  
on Capital Values

I thought you might want a brief summary of the main points in both memoranda.

## Blough Memorandum

Blough's memorandum summarizes the Chairman's proposal and then proceeds to enumerate some possible difficulties without discussing them in detail. The main points are:

1) The tax might not effectively check such appreciation in the price of capital values as might arise from non-speculative purchases. Due to the high level of income and scarcity of goods available there might be substantial pressure even without speculation.

This, of course, is correct but I believe it is the Chairman's point that if speculative increases in capital values are successfully checked, the remaining increase will not be excessive and in view of low postwar interest rates may to some extent be desirable.

2) The high capital gains tax might result in a thinner and less stable market. To the extent that it would freeze assets in the hands of present holders it might reduce the supply and thereby increase inflation pressure. This would apply particularly to assets held by people who purchased them prior to introduction of the tax. By holding on to these assets investors can look forward to a tax-free appreciation in values, which would not be the case if they liquidated existing holdings and switched into new assets. A thorough analysis of investment behavior in response to the tax is required.

This is very true. The argument that a high capital gains tax may result in a thinner and more volatile market was mentioned a great deal in the capital gains tax discussions in the thirties and within limits it may well be true. However, if in the absence of the ~~tax~~ a really violent inflation would result from speculative purchases, inflation would surely be less if the tax was applied. If without the tax only a moderate increase in values would occur, application of the tax might affect values little.

3) The tax will be effective only if investors believe that the rates will be continued for some time.

I take it Mr. Blough does not refer to continuation of the tax with respect to new purchases but assurance that the tax will not be repealed retroactively for purchases currently made. If the tax was once adopted I doubt whether this danger would be very great.

4) Possible deterring effects on investment during the transition period are mentioned but briefly and no special suggestions are made.

5) If a heavy tax on capital gains is imposed and there are substantial inflation pressures, taxpayers will try very hard to evade the tax either by predating purchases or by transforming what are actually capital gains into other income (the opposite of current practice).

I agree that this will probably be the case. But if the capital gains tax proposal was otherwise desirable I do not believe that some degree of evasion would seriously weaken the case. Evasion would be a defect in equity rather than in inflation control.

6) Congress is now interested in postwar tax reductions. Hence it will be extremely difficult to persuade the Committees that an increase in taxes is needed. Certainly this could not be done without showing that a drastic inflation in capital values is not only possible but probable unless the tax was imposed.

I think that this is the most important point. It would be extremely difficult now to persuade the committees to be sympathetic towards higher taxes. Since the proposal would have to be kept confidential to avoid an inflationary rush into purchases of capital assets, it would be particularly difficult to prove the case by drawing on experts in the field.

#### Purcell Memorandum

Again, the main points are summarized:

1) Mr. Purcell believes that substantial further increases in capital values may be ahead and mentions signs of increased speculation during the last year or so.

2) He believes that wartime taxes have been discounted thoroughly by the present market and that current taxation will be no curb to a coming rise in values; however, heavy tax on capital gains would be a different matter.

3) An increased capital gains tax, combined possibly with requiring a minimum holding period for new purchases, would tend to check an increase in values but it is not felt with any confidence that either of these measures or both will prevent a potential increase in security prices. There is substantial question as to whether security prices as distinct from trading volume and speculation can be feasibly controlled. However, a tax of the kind here proposed would most likely be effective in preventing widespread public participation in speculative price movements.

4) Mr. Purcell lists 21 points which will affect the future level of security prices, the outlook for the level of income being the most important.

He believes that security prices will tend to be higher if people expect that the Federal government will be led by liberal and progressive rather than by conservative personalities, because in this case, expectations will be greater that a high level of income will be underwritten. Similarly, he believes that liberal postwar basic wage rates and labor union policies will have a more stimulating effect in the long run than conservative policies.

The Chairman's proposal will be discussed at the Inter-departmental Tax Committee meeting this afternoon and I shall report to you tomorrow.