

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 20, 1936.

To Chairman Eccles

Subject: A possible way of checking the

From Lauchlin Currie

evasion of taxes designed to

L. C.

deter the inflow of capital.

I don't know whether the attached suggestion is a good one or whether I have overlooked something important. I should very much like to talk it over informally with Opper if you have no objection.

Carroll

November 20, 1936.

A POSSIBLE WAY OF CHECKING THE EVASION OF TAXES DESIGNED TO DETER THE
INFLOW OF CAPITAL

It is common knowledge that the Treasury has never been successful in collecting more than a small portion of the income and capital gains taxes applicable to foreigners. The repeal of the capital gains taxes and the surtaxes applicable to foreigners in the Revenue Act of 1936 and the substitution of a flat 10 percent tax on income was in part a recognition of the fact of wide-spread evasion and of the growth of trading in American securities in other markets. Congress in effect said, "We cannot hope to tax foreigners as we do Americans. Let us therefore repeal the capital gains tax and try to prevent a further loss of business to our security exchanges."

It would appear, therefore, futile to initiate a stock purchase tax or a capital gains tax applicable to foreigners unless some means can be found to prevent the evasion of such taxes through the development of markets in our securities abroad. The following suggestion is designed to prevent this form of evasion:

Require that all stocks in American companies listed on our stock exchanges be legally transferable only by gift, by private sale subject to the approval of the S. E. C., or by sale on American stock exchanges. Evidence that the stock had been transferred in one of these three ways would have to be furnished to transfer agents before the transfer could be effected.

Any purchase or sale by non-residents would either have to be negotiated directly through an American broker or indirectly through a resident. Other--

wise non-residents would have no legally enforceable claim to the stock or to the dividends payable on the stock. Hence, information could be obtained from brokers' books without fear that this would involve loss of business to American brokers, as has happened formerly when information on transactions of foreigners was obtained in this way.

This provision would not prevent the issue of and trading in abroad of bearer certificates representing ownership in American stocks. It would, however, require the payment of the purchase tax whenever more American stocks were purchased against which additional bearer certificates are issued.

In order to prevent Americans abroad from purchasing stocks for foreigners on our stock exchanges and in this way avoiding the payment of a purchase tax, the tax might be made applicable to all non-residents rather than to non-resident aliens.

The proposal has the additional merit of preventing the growth of trading abroad by Americans for the purpose of evading margin requirements and capital gains taxes. Its legality could be defended on the grounds that it was necessary for the effective exercise of powers that are constitutional. It would not apply to bonds nor to foreign stocks, such as Canadian Pacific, listed on our exchange.

The American broker, if the purchase were direct, or the resident nominee or correspondent, if the purchase were indirect, could be made responsible for the payment of a 5 percent stock purchase tax

and, possibly, a flat capital gains tax at the time of sale. It is far easier to discover and prosecute resident than non-resident evaders.

One of the most effective ways of checking evasion and of deterring foreign purchases of our stocks would appear to be to impose a flat income tax of say $22\frac{1}{2}$ percent (the same as in Great Britain) to be deducted at source in the case of stocks registered in the names of non-residents and to be declared and paid by resident agents or correspondents in the case of stocks held here on non-resident account. Possibly a lower rate might be advisable for dividends going to residents of contiguous countries. Consideration might even be given to the imposition of a high income tax deducted at source in lieu of a capital gains tax.