Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date June 26, 1937

To Chairman Eccles

Subject:

From Malcolm H. Bryan

Dear Mr. Eccles:

Here is the memorandum, but I am afraid it is not entirely what you wanted. I got started and could not stop.

I will be at home (Columbia 3674) after eight this evening. I will come down early in the morning and try to revise this in any direction you desire, in case a revision would be useful.

M.H.B.

Form F. R. 131

BOARD OF GOVERNORS
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# Office Correspondence

Date June 26, 1937

To Chairman Eccles

Subject: Taxes discussed to repel the inflow of foreign capital and gold.

From Malcolm H. Bryan

I. In accordance with your request, I am making the following brief statement regarding the discussion of taxes to repel the inflow of foreign capital and gold:

1. There seems to be substantial agreement that increased taxes (of a withholding-tax type) will be required in connection with recurrent income of foreigners from interest, dividends, and other such items as are listed in the present law.

2. While there has been less agreement on the taxation of capital placed here for speculative profits, there is no reason to alter the position that speculative capital must be subjected to substantial taxation if we are to impede the inflow of capital and gold to the extent required in the present situation.

> Even with the most inclusive taxation of foreigners that is constitutionally and administratively possible, there will still be broad avenues for such investment—state, municipal, and (probably) Federal issues, plus direct investments in American real estate and business property. If the speculative markets are in addition left open to untaxed capital gains, the avenues for the inflow would be so easy and attractive as to make taxation hardly a useful tool for getting us out from under the gold problem.

II. You are familiar with the tax proposals forwarded to you in various memoranda. These may be briefly recounted as follows:

1. The first has been an increase in present withholding rate in order further to reduce the attractiveness of the United States to investment capital.

2. The second has been a capital gains tax to deal with speculative capital.

> This tax has been suggested (1) at a flat rate of from 10 to 25 per cent (depending on a final decision as to the rate necessary), (2) without deduction for losses (in order to provide a large deterrent to the in-and-out speculator who expects a gain on balance), (3) confined to stock certificates, on which the chief capital gains occur (in order to make the tax easily administrable), and (4) the tax has been proposed in a capital gains form, in preference to other taxes to accomplish the same purpose, so that a premium would not be placed on dealings in American securities in the foreign as against American security markets.
>
> The administration proposed is through American transfer officesand American brokerage houses who hold stock securities for foreigners. In the discussion of the tax, a very large number of various examples have been put forward from all sides but no example has thus far come to view in which the administration would not be easy and effective.
>
> Two Treasury criticisms of which I have been verbally informed are that the non-deductibility of losses is a discrimination against the foreigner and that the administration would involve making American brokers and transfer offices discretionary agents of the Treasury. The first is correct; and that element of the proposal can be eliminated, though its elimination will remove a useful feature of the tax. The second criticism (regarding discretion) is incorrect. Even if it were correct, the criticism would be relatively unimportant and easily remedied. There may, of course, be other and fatal criticisms of this suggestion that the Treasury has for some reason not seen fit to convey to us.

III. It is impossible at this time for me to inform you precisely regarding the Treasury's current thought on the problem of taxing foreign capital. The only information available to me is from informal conferences to which I have been invited. At the moment, however, (Saturday, June 26) Treasury opinion appears to favor taxes of the following character:

1. The first tax would be a withholding tax of 22 per cent on interest and dividends and other recurrent items of income payable to non-resident aliens and non-resident foreign corporations.

Provision would be made for filing of returns (at least in the case of individuals), which would include not only all income from American sources but all income from foreign sources. The foreigner would be taxed upon the basis of the rate applicable (if less than 22 per cent) to an American national having the same total income, and would be accorded a $1,000 personal exemption, plus an allowance for dependents if he were the resident of a contiguous country. It is said that the administration of this tax could be accomplished by (1) having the foreigner who wishes to ~~take advantage of it~~ file a return notarized before American consuls abroad, (2) submit copies of his foreign income tax return, and (3) submit such other proofs of total income as would be satisfactory to the Bureau of Internal Revenue. It is added that in the administration of the tax the proofs of income required of a foreigner would be so severe as to make the privilege of filing a return, practically speaking, an illusion. The idea is, I am told, that nearly all foreigners would in fact pay the 22 per cent.

The following points can be made:

(1) It will be necessary for the tax rate to be applicable on at least the security income of resident foreign corporations in the United States. Otherwise (as is true in our present law), avoidance will be wide open through the procedure of setting up offices or places of business in the United States and taking advantage of the 85 per cent exemption of domestic dividends.

(2) The administrative reliance proposed is not convincing.

a) An affidavit by a taxpayer is only useful when he is open to criminal prosecution for false swearing, which would not be true in case of a foreigner because his person is beyond the jurisdiction of the United States.

b) If a foreigner submitted a valid copy of a foreign income tax return, it would be unsatisfactory because the elements entering into income--in Great Britain, for instance, the non-taxability of capital gains--differ so widely from taxable income in the United States. It would be necessary for us practically to reconstruct the taxable income.

c) Even if income under foreign tax laws were identical with the United States, and we accepted foreign tax returns as proof, then our income tax administration with respect to certain foreign nationals would be no better than the administration in their home country, which is in many instances notorious.

d) There is little or no possibility of our providing against foreigners splitting their income into several different tax returns, so that each return, even if honestly made, would fall in a bracket much below our 22 per cent rate; and this criticism would apply whether we attempt to allow the filing of returns with respect to a foreigner's total income or merely with respect to his income from American sources.

e) The proposal that a foreigner be allowed $1,000 exemption on his income would permit a substantial amount of capital coming into the United States untaxed, the amount of capital depending on the yield of his securities.

Altogether, the program for allowing foreigners to file returns does not appear to be a neat and practicable device and is likely to develop into an administrative mare's nest. However, if the Treasury feels assured (1) that avoidance by means of resident foreign corporations will be closed and (2) that the option permitting the filing of returns can be administered so stringently as to make the minimum rate in practice 22 per cent on recurrent items of foreign income from American security investments, then there is no reason why the proposal for a 22 per cent withholding tax should not be a real deterrent to incoming investment capital. The suggested rate is, curiously, more severe than any proposal ever made in this connection in behalf of the Board.

2. The present Treasury thought regarding a tax to deter speculative capital is in the direction of a 2 or 3 per cent tax on the gross proceeds of all transactions for foreigners. It is assumed that such an amount withheld

from each purchase and sale would pile up a large sum and compel the foreigner to file an American tax return.

(a) The assumption behind the tax on proceeds is contrary to any reasonable expectation. All foreign transactions in American securities would occur on foreign markets except at such times as there was being a net outflow of securities from the United States or a net inflow. On such occasions the foreign price would be the American price plus tax or the American price less tax. The fact is, therefore, that with a transactions tax the United States would withhold only twice during the foreign career of each security certificate: once when the certificate left the United States and once when it returned. A 2 per cent on gross proceeds, therefore, would amount to a total tax of 4 per cent.

(b) The transactions tax would cause a loss of between 8 and 10 per cent of the total volume of business done by American brokers.

The preceding considerations with regard to this tax do not mean that it could not be used. All that is necessary for its use is sufficient determination in the face of American brokers who will point out that a premium is placed on foreign markets and a large business loss occasioned when an equally effective tax less likely to have similar results is available. It is my opinion, however, that a tax of much more than 2 per cent on purchases and sales will be necessary in order to make the tax a really effective deterrent to the inflow of speculative capital, since a 2 per cent tax, spread over the large number of transactions through which the securities would go abroad, would become an exceedingly small levy on each actual transaction.

It has been orally suggested that we could prevent securities from going abroad because of the transfer tax by levying a heavy stamp tax on all securities exported or trusteed in the United States for foreign trading. This is impracticable because of the Constitutional prohibition of export taxes.

The last verbal suggestion made, of which I am aware, is that we levy a 2 per cent tax on transactions and, if the security is exported abroad or trusteed in this country, it should be stamped (as in the plan suggested in my memorandum of April 27) with its purchase price and other data, so that, when resold to an American, a flat capital gains tax of 22 per cent could be applied to all profits. If I have understood this verbal suggestion correctly, it should be administrable and quite as much of a deterrent as any proposal made in behalf of the Board. In fact, it is somewhat more severe than such proposals because, on any transaction in the American market, there is a 2 per cent tax on the gross proceeds, regardless of whether the foreigner has a profit or a loss. The fact that the 2 per cent tax on transfers will cause foreign transactions to be taken from American markets and consummated in foreign markets, under the conditions noted above, is the only objection to this combination of a transfer tax and a capital gains tax in the same way that it is an objection to a transfer tax alone.