

March 11, 1936.

Curtis

SUGGESTED AMENDMENTS TO PROPOSED TAX ON UNDISTRIBUTED CORPORATE INCOME.

I - Exempts

- a. Income devoted to "reasonable" retirement of debt outstanding on March 1, 1935. "Reasonable" is to be interpreted as the annual rate of retirement provided in any bond indenture or other loan contract outstanding. In the absence of such contract "reasonable" should be interpreted as a rate of annual payments sufficient to retire outstanding debt at maturity.
- b. Income devoted to retirement of preferred stock outstanding on March 1, 1935, provided a corporation has contracted to retire such stock or to set up a sinking fund for this purpose.
- c. Income devoted to payment of delinquent taxes.

Unless exemptions such as these are allowed, injustice will be done to borrowers who either entered into contractual obligations to retire debt or expected at the time of borrowing to retire debt out of current earnings. For the future it would be understood that debt retirements would be handled either by (a) using depreciation reserves, or (b) issuing new stock. For the most part the exemption would benefit corporations in straightened circumstances, such as small corporations heavily in debt to banks, real estate corporations, and railroads and public utilities. Most of the very large and profitable manufacturing corporations are out of debt. The agitation for exemption of "reasonable" reserves might be met by granting exemptions for the purposes mentioned above and the opposition thus diminished.

II - Except undistributed earnings of banks so long as capital and surplus together are less than 20% of deposits. It might be well to require also that present capital plus future subscribed capital should be at least equal to surplus, in order that advantage may be taken of this exemption.

The larger the capital and surplus of banks, the less danger there is of loss to depositors and to the Federal Deposit Insurance Corporation. Interest rates are low and may remain low for a considerable period. Banks' earnings, therefore, are also low and many banks experience difficulty in raising new capital, although the rapid increase in deposits makes this desirable. In these circumstances it may prove to the best interests of the country to encourage banks to strengthen the proprietors' interest by reinvesting earnings.

III - For the purposes of the proposed tax, undistributed income should be income undistributed by March 1st of the succeeding year.

Corporations do not know what their earnings have been until after the end of the year. Adequate time should be allowed for the declaration of a final dividend after the result of the year's operations is known.