March 21, 1945.

Honorable Arthur H. Vandenberg,
United States Senate,
Washington 25, D. C.

Dear Arthur:

You alluded, I trust facetiously, to my suggestion of a capital gains tax when we were at dinner the other evening. I value your judgment so much that I hope you will not form any final opinion about it until you have had an opportunity to weigh all the pros and cons, as I have tried to do. I do not like this or other expedients dealing with the effects rather than the causes of the inflationary danger, but having failed to deal adequately with the causes, there is no alternative but to try to deal with the effects if we are to hold the line.

I have very carefully considered the objections to this particular expedient. They narrow down to two: One, that the tax would tend to freeze the market -- I do not think there is anything in this except the dismay of brokers who thrive on volume and instability -- and the other that it would deter risk capital in the postwar. So, of course, would the wartime levels of individual and corporate taxation.

The argument that the tax is a deterrent to venture capital has been grossly exaggerated. There is no reason, of course, to be concerned about venture capital in wartime when we have a scarcity of men and materials. Looking to the postwar, however, everything possible should be done to give the greenlight to risk capital. We ought to have more investment in equities and less in debt forms. The best way, in my opinion, of encouraging venture capital would be (1) by reducing the double taxation of equity capital. I would give a credit to corporations for dividend disbursements, the credit to be 25 per cent or the full amount of the normal corporation tax. As the dividends thus received would be subject to the individual income tax, double taxation should be avoided by giving the 25 per cent credit or exemption to the corporation disbursing the dividends. Such a credit would, on the one hand, be an inducement to the corporation to disburse earnings, and, on the other hand, an inducement to the investor to put his money into equities for the income; (2) by providing an exemption of $25,000 from the excess profits tax. While this would not matter much so far as the large corporation is concerned, it would be a great boon to the smaller and medium sized concerns.

Instead of having a very low capital gains tax or none at all, it would be far better to retain the tax in such a form as to penalize the speculator, who is thinking in terms of a relatively quick turnover, and thus to encourage the real investor, who is thinking in terms of income or longer-range appreciation, to put his money into equities. The low capital gains tax of the late 20's, far from encouraging venture capital to go into new production, provided a strong incentive to turn instead to making money the easy way in stock market speculation that furnished neither employment nor new wealth. It is upside down now. We have necessarily high wartime surtaxes and excess profits taxes which discourage investment, but a low capital gains tax that encourages the speculator.

I do not know whether anything specific is going to be put up to the Congress on the capital gains matter, but if it is I am sure you want to study it very carefully before coming to a conclusion. Like so many things, it is a question of a problem and deciding what alternatives would be most effective in dealing with it.

With kindest personal regards,

Sincerely yours,

Enclosure

ET:b

United States Senate

COMMITTEE ON FINANCE

March 24, 1945.

Honorable Marriner S. Eccles
Board of Governors
Federal Reserve System
Washington 25, D. C.

My dear Marriner:

I appreciate your letter of March 21st, with its enclosure.

I think you know that I have come to have the deepest respect for all of your opinions and viewpoints. Perhaps I shall ultimately agree with you about the capital gains tax. At the moment it seems to me that it has more liabilities than assets. Certainly I agree with you that "looking to the postwar everything possible should be done to give the greenlight to risk capital." I should think that this ought to include a healthy stock market, not only because of the transactions themselves but also and particularly because so much of the country (no matter how illogically) seems to look upon the status of the stock market as a national barometer, (which in turn spells "confidence" or lack of it). Of course I agree that we do not want wrong way marks and high pressure speculation. Neither do we want the speculative promise of stock market specualtion to outbid new enterprise which will seek and require vast venture capital for new production. But I confess that I have had the feeling that a vigorous stock market is one of the essential elements in a national economy at the level which we are told we must maintain in the postwar world.

Therefore, I have been critical of the capital gains tax in this connection. But I shall take your warning, at least to the extent of awaiting a chance to talk more intimately with you about this problem before I return a verdict.

I deeply appreciate the spirit in which you have written.

With warm personal regards and best wishes,

Cordially and faithfully,

A H Vandenberg