

May 15, 1945.

Mr. Walter Lichtenstein, Secretary,  
Federal Advisory Council,  
C/o First National Bank of Chicago,  
P. O. Box A,  
Chicago 90, Illinois.

Dear Mr. Lichtenstein:

It was evident from yesterday's meeting that all the members of the Advisory Council were interested in the capital gains tax as a now somewhat belated but, in my opinion, necessary curb on speculative activities that add to the inflation problem. It also appeared that not all of the members had seen an explanatory statement that I gave out after I was unexpectedly questioned on this subject when I testified before the Banking and Currency Committee on the gold reserve bill. Accordingly, I am taking the liberty of sending you a copy, in case you might care to look it over.

I do not like the tax any better than I like any other direct controls but it is, of course, a matter of alternatives at this time. And I see no other effective over-all instrument that will reach not merely stock market speculation but the speculative activities affecting farms, homes and other capital assets. It may well be, as was pointed out at the meeting, that holders of securities would be disinclined to sell since they could not get in the market again without being subject to the wartime tax, whatever its form may be -- and I would suppose that if the Congress enacts such a tax it will extend the holding period, which should be 36 months if it is to be effective in the real estate field. But even conceding that much, it is apparent that the deterrent effects of such a tax would be on the buyer rather than on the seller and, in any case, it is inconceivable that there would be any runaway market conditions due to speculative influences.

More important to my mind is the longer range problem of adjusting the tax structure to give the greatest possible inducement to venture capital. It does seem to me that to that end it would make sense to continue some sort of penalty on the speculative buyer; that is, the one who is purchasing with the idea of selling out at a profit after a comparatively short time, and to put a premium upon risk capital by special tax inducements to the real investor who is not thinking in terms of the quick turnover, but is looking for income and longer-range appreciation. With this in mind, I have previously suggested that

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what would really encourage risk capital in the postwar would be to reduce the excess profits tax from the present 95 per cent maximum to possibly 65 per cent and to make the corporation tax 25 per cent instead of 40 per cent, as it is now with the surtax. I would then exempt from the 25 per cent corporate tax all profits paid out in dividends which would be taxed in the hands of the recipients. This would avoid the double taxation that has been so great a deterrent to the investor in productive enterprise in the past. At the same time, I would give an exemption of \$25,000 to all corporations under the excess profits tax. This would not matter much in the case of a large corporation, but it would be a tremendous benefit to the smaller and medium-sized concerns.

Today when interest rates on fixed income bearing obligations are low and security yields high by comparison, there is every reason for the speculator to take advantage of the capital gains loophole, which is the most serious breach in the line of defense against inflationary forces. In the late 20's the capital gains tax was comparatively low, as were corporate and individual taxes, while interest rates were relatively high and, by comparison, security yields comparatively low. Nevertheless, in that period venture capital, instead of going into enterprise that would in turn furnish employment, was drawn more and more not only into buying and bidding up the prices of existing securities of established corporations, but particularly into stock market operations that added neither to employment nor to production. That was the heyday of corporate mergers, combinations and consolidations, of monopolistic growth, of the holding company and of the investment trust. Over 1200 mergers, involving some 4000 companies, took place in the 20's. Holding companies flourished in industry, trade, transportation, and in almost every other line from chain groceries to utilities. While it lasted, it was wonderful for the Insulls, but small business enterprise was all but forgotten.

It has been estimated that of more than \$40 billions of domestic corporate issues floated on the booming stock market in the 20's, some \$10 billions were the offerings of investment trusts, holding companies and financial institutions. Those \$10 billions, together with about \$6 billions more of corporate refunding issues, represented financial operations that were not a contribution to employment or production. Of the remaining \$24 billions of flotations, an indeterminate amount similarly represented such operations rather than investment in new plant and production. In other words, there was a premium on speculation in existing securities instead of a penalty. There was a penalty on venture capital instead of a premium. To my mind, it was just upside down.

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I have ventured to set forth these comments because the matter is one of importance as a part of this general picture which we discussed yesterday, and I know that the members of the Council want to weigh all the pros and cons before reaching fixed conclusions about such a matter as the capital gains tax.

Sincerely yours,

M. S. Eccles,  
Chairman.

Enclosure

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(IDENTICAL LETTER TO MEMBERS OF THE ADVISORY COUNCIL, WITH THE EXCEPTION OF MR. SPENCER AND MR. FLEMING, WHO DID NOT ATTEND MEETING. LETTER WAS SENT TO MR. BEAL AND MR. RIEMAN WHO ATTENDED IN THEIR STEAD.)