

FROM:
THE AMERICAN BANKERS ASSOCIATION
THE NEWS BUREAU
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TAX JUSTICE AND THE 87th CONGRESS

Address of M. Monroe Kimbrel, Vice President of The American Bankers Association, before the Mid-Winter Meeting of the Ohio Bankers Association, the Neil House Hotel, Columbus, Ohio, on Thursday, February 22, 1962. Mr. Kimbrel is Chairman of the Board, the First National Bank, Thomson, Georgia.

At this very moment, in a Congressional Committee room in Washington, a legislative issue of the greatest importance to commercial banking may be under discussion.

On Monday the House Ways and Means Committee began final consideration of the Administration's limited tax revision recommendations, including equitable taxation of savings and loan associations and mutual savings banks.

This is the "tax package" which will soon come before the House of Representatives on a take it or leave it basis. The House rules will permit one motion to send the bill back to committee, but no amendments can be offered.

Late in January the Ways and Means Committee tentatively decided on a formula for taxing mutual financial institutions. Whether this formula will get the Committee's final O. K., and if not, why not, is something I would like to discuss today. As with every controversial issue, this one is fraught with politics, pressures, arguments, and counter-arguments. Each of these facets merits our attention, although their full magnitude will not be known for some time.

On January 30 the Committee adopted a tentative plan for taxation of the mutuals providing, in effect, for tax-free transfers to bad debt reserves equal to 3 1/2 per cent of net loan growth, in place of the 12 per cent bad debt reserve which has enabled these institutions to remain virtually tax free.

This proposal also provided for a three-year transition period, during which time the rate on their taxable income would be gradually increased. By 1966 savings and loan associations and mutual savings banks would be subject to full taxation on income retained after payment of dividend and after authorized transfers to reserves.

The revenue gain from this formula, assuming normal growth over a four-year period, is estimated to be in the neighborhood of \$585 million by 1966.

A.B.A. reaction to this provision came in the form of a statement by President Fleming, who said the Committee's action was "a strong and constructive step toward accomplishing the objective of requiring the savings and loan associations and mutual savings banks to bear a fair share of the nation's tax burden."

He made it clear, however, that the proposal would not provide for full nondiscriminatory treatment as had been requested several times by President Kennedy. While tax justice is approached by the Committee's formula, we still believe that the mutuals, like all other profit-making businesses, should have no larger tax-free reserves than those which can be justified on the basis of operating experience - and the mutuals cannot even justify a 3 1/2 per cent reserve.

Our efforts to improve upon this formula are tempered to a large extent by the factors I mentioned a minute ago. Legislation affecting a powerful and influential segment of American business, such as is the case here, is seldom decided solely on the basis of what is right and what is wrong. Unfortunately, we must accept the fact that the legislative process reflects not an impartial course of action based on a set of given facts, but rather the interests of 537 individuals who may, and do, have other motivation.

President Kennedy has repeatedly asked for a nondiscriminatory tax law and the majority of his party seems to be guided by this request. The

inequity of present tax laws concerning competing financial institutions has also been recognized by the Republicans, as evidenced by a similar recommendation from the Eisenhower Administration.

There is some evidence that a number of Republicans would vote against the tax package because of its other provisions, like dividend and interest withholding, but not in sufficient strength to defeat the measure. Politics, then, has not been much of a factor.

Pressure is something else again.

It is an axiom of the democratic form of government that all citizens have the right of petition and that minority and special interest groups have the right to protect themselves against encroachment by the majority.

We all recognize these principles and, in fact, practice them to a certain extent through the operation of our various bankers associations.

I will not dwell on this point because I am sure you are all aware of the pressures being put on Members of Congress by the mutual institutions. Commercial bankers have exercised a good deal of restraint in this field for one simple reason. It can be overdone to the degree that it is crude and extremely annoying. When this happens the whole effort can backfire, and I firmly believe that it will in the case of the mutuals.

However, there is another tenet which, while not as universally accepted, still has some supporters in present day politics. That is the placing of public welfare considerations, the common good, and the concept of equity ahead of selfish interests. It may be that these principles will prevail in the case of tax uniformity.

We now come down to the point where the arguments and counter-arguments enter in.

Exactly what are we facing in the way of opposition to an equitable tax law? Some of the arguments are old ones, such as the effect on the growth

of savings and loans and mutuals and the effect on the availability of mortgage funds if they have to pay taxes like everybody else.

At least one argument is relatively new, and that is: What formula would provide nondiscriminatory tax treatment for mutual financial institutions? I say relatively new because the same question has already been asked, and answered, by the Treasury Department and commercial banking.

Lately the question has been posed by representatives of the mutual institutions themselves, and the reason for it is a major development in this whole issue.

The mutual industry has conceded that it will have to pay more Federal income tax than it has been paying. It is now trying to keep the increase as small as possible.

Representatives of the industry are urging Congress to accept what they call a "compromise" proposal in lieu of what the Committee on Ways and Means tentatively adopted.

Even an old Ohio horse trader would blush at the terms of this so-called compromise.

It calls for a bad debt reserve of 5 per cent and would subject only 75 per cent of their net income to taxation after payment of dividends and interest.

On the surface the 5 per cent would appear to be a fine middle ground. After all, they say, it is pretty close to the 3 1/2 per cent figure.

But on any other terms, such as loss experience, equity, and amount of revenue to be produced, it is absolutely ridiculous!

Take loss experience for example. During the five worst years of the depression the largest loss taken by savings and loan associations was equal to only 1.8 per cent of loans. Total losses for the years 1930-34 were less than 5 per cent of the average annual loan volume. Mutual savings banks were able

to defer taking heavy depression losses until the early 1940's so that their largest loss in that period amounted to only 0.6 per cent of loans. Their total losses for the 1930-34 period were only 2.1 per cent of average annual loans outstanding. Commercial bank losses on loans were equal to 2.8 per cent in 1933 and to 3.3 per cent in 1934. Our loss ratios were not only substantially greater than those of the mutual institutions but larger also in each year than the present maximum reserve ratios - 2.4 per cent - now permitted the average commercial bank.

Take equity, for a second example. The Treasury has estimated that on a basis of experience the mutual institutions would be entitled to a bad debt reserve of between 2 and 3 per cent. Even a 3 1/2 per cent reserve is at least 40 per cent greater than could be justified as a reasonable bad debt reserve. A 5 per cent bad debt reserve limit in 1960 would have permitted savings and loan associations to obtain tax credits 117 per cent greater than under a true bad debt reserve formula, while for mutual savings banks the advantage would have been 317 per cent.

And if Congress is interested in obtaining any revenue at all from the mutuals it should be wary of a 5 per cent bad debt reserve level. There is no question that under a 5 per cent formula many mutual institutions will escape all tax and many others will pay only negligible taxes. Moreover, these will be the institutions which are most prosperous and growing most rapidly, while the only tax of any consequence will fall on the mutual institutions growing most slowly. All a savings and loan association would have to do under the 5 per cent provision is increase its dividend payout and reduce its reserves, thereby avoiding payment of any tax.

A 5 per cent reserve limit for mutual institutions places a tremendous premium on growth by providing an irresistible temptation for many institutions to avoid all tax payments, and it will not take long for most of them to take advantage of the opportunity.

The mutuals also continue to maintain that taxes will compel a substantial reduction in dividend rates, thereby depressing both the growth of these institutions and the flow of funds to the mortgage market.

The American Bankers Association has challenged their argument at every opportunity and just last week the Treasury Department voiced its conclusion that the possible effects on dividend rates of a bad debt reserve in the range of 2 to 4 per cent would not appear to be large enough to appreciably affect growth in savings and share accounts.

As for the contention that a shortage of home mortgage funds will occur, the mutuals have even added a sentimental touch. They now claim that, if they are taxed, the bumper baby crop of 1966 will go unhoused. This puts anyone favoring tax uniformity in the position of being for sin and against motherhood. But at this point I would not put anything past them. That such a statement can be made at all is only mildly surprising. When it runs directly counter to the facts, someone has grasped at the last straw - and missed!

There has been no shortage of home mortgage funds during the past year, nor does any shortage appear imminent. Even mutual spokesmen have commented on the availability of mortgage funds and have predicted that there will be a surplus of these funds during the next five years. In addition, the Housing and Home Finance Agency has recently estimated that there will be a surplus of funds available for home mortgage funds for the next ten years.

Finally, and of recent vintage, commercial banks are moving more aggressively into the residential mortgage area, with a consequent substantial increase in the availability of mortgage funds.

The A.B.A. has received numerous reports of commercial banks actively seeking ways and means of investing savings in mortgages. If only an additional 10 per cent of the savings available in commercial banks is shifted to mortgage investments, the new mortgage funds available would be in the neighborhood of

\$4 or \$5 billion a year. Thus, the situation with respect to home mortgages is just the opposite of that suggested by the mutual industry.

These are just a few of the temporary roadblocks being raised by the opposition. As bankers, you probably do not think much of the mutual industry's arguments and wonder why they constitute any problems at all.

The plain fact is that they raise the spectre of a housing shortage and all sorts of other bad things which could turn Congressional and public opinion against any increase in taxes.

I discussed them here because we, as bankers, can do much to dispel the false impressions they create, both with the Congress and with the public.

The basic question always has been: How much tax should be paid by a \$120 billion industry. Until the obvious answer is accepted by Congress and the taxpayers, we will have to keep untangling these barriers.

Whatever tax formula comes out of the Committee will be subject to scrutiny by the Senate and by the American people. Whether it provides for a reasonable tax or not, we have our work cut out for us. If an equitable formula is approved by the House, it will have to withstand these and other arguments all over again. However fallacious they may be, the allegations of the mutual industry are calculated to arouse fears - and they do.

Should a meaningless formula be voted out by the House, we have the task of proving that it is meaningless and improving on it in the Senate.

The Senate Finance Committee plans to hold hearings on the tax package as soon as it is passed by the House. Senator Harry Byrd of Virginia, Chairman of that Committee, is not expected to obstruct the bill's progress in the Senate, despite his objections to certain features now in the draft measure.

This brings us to the question of dividend and interest withholding, another part of the proposed tax measure.

The A.B.A. still takes the position that a practical, workable withholding system has not yet been offered. The Ways and Means Committee has modified its original action to provide for withholding at a 20 per cent rate, instead of 16 2/3 per cent. No exemptions would be provided for dividends, but in the case of interest on bank accounts, and share accounts in savings and loan associations and mutual savings banks, exemption certificates would be allowed for certain classes of people.

Children under age 18, for example, could file exemption certificates whether or not there is a reasonable anticipation of no tax liability. This certificate need be filed only once and would exempt the child's income from withholding until he became 18.

Persons aged 65 and over could file exemption certificates where they reasonably foresee no tax liability for the taxable year. This certificate would have to be filed annually, but the Treasury could extend the certificate for a longer period.

No exemption certificates would be provided for persons between ages 18 and 65, but they could file for quarterly refunds on both dividend and interest income.

Because of the peculiar situation facing us in the House of Representatives, further opposition to withholding must await Senate consideration of the tax measure.

The Ways and Means Committee is almost unanimous in its support of withholding, and, as I say, no floor amendments will be accepted when the Committee bill is debated.

To attempt to defeat or recommit a tax measure with a favorable tax uniformity provision because of its withholding feature would be inadvisable. Bankers would have to get behind such a bill and give it all the support possible. We must first ensure that the measure passes the House, and then do what

we can on withholding in the Senate. I am sure the Ohio Bankers Association shares these sentiments and will offer full assistance and cooperation.

All other banking legislation has taken a back seat to tax uniformity and withholding for the time being.

Toward the end of January the House Banking and Currency Committee did hold an executive session on the National Bank Loan Limits bill and the measure which would improve the usefulness of national bank branches in foreign countries. The loan limits bill ran into some unexpected opposition, causing final approval of both measures to be put off for a while. It is anticipated, though, that the Committee will act favorably on these bills in sufficient time to secure passage before adjournment.

Committee Chairman Brent Spence of Kentucky is the author of the National Bank Loan Limits bill, which was introduced at A.B.A. request. It would increase the aggregate amount of real estate mortgages which a national bank may make from 60 to 70 per cent of time and savings deposits. We estimate that an increase in the lending limit would add nearly \$4 billion to the mortgage investment potential of national banks.

One bill introduced at the outset of the second session should hold a great deal of interest for bankers. Introduced by Senator Metcalf of Montana, it would provide that Federal savings and loan associations may establish and operate new branches in States only if State savings and loan associations or State banks and trust companies are permitted by State law to establish and operate new branches. Branching across State lines would also be prohibited by the bill.

This measure is similar to a provision in the House version of the Financial Institutions Act of 1957 which failed to pass. The A.B.A. has supported such legislation in the past and will do so again if hearings are held.

The recommendations of the Commission on Money and Credit received a boost when President Kennedy made reference to them in his economic message. The President said the Commission's proposals deserve careful consideration by Congress, the Executive Branch, and the public. To this end he announced that he will appoint an inter-agency group to examine the issues and to keep in touch with Congressional committees having jurisdiction in areas covered by the Commission's recommendations.

Capital Hill observers see little chance of the C.M.C. recommendations being considered unless the inter-agency group specifically recommends hearings. To date only one bill has been introduced on this subject. Senators Clark of Pennsylvania and Wiley of Wisconsin have sponsored a measure dealing with the Commission's recommendations on the organization of the Federal Reserve System, but no action is scheduled.

Recently the A.B.A.'s Federal Legislative Committee met in Washington and made several recommendations concerning the C.M.C. proposals. The Committee recommended opposition to the requirement for mandatory membership in the Federal Reserve System in order for a bank to be granted an insured status. It also opposed the recommendations for coterminous service of the U. S. President and the Federal Reserve Board Chairman, and for substitution of non-interest bearing certificates to member banks in place of Federal Reserve bank stock holdings.

No action has been taken on several bills carried over from the first session, nor is any scheduled. These include the Douglas Disclosure bill, the proposal for a Federal Mutual Savings bank system, and the State Supervisors bills. Senator Douglas is expected to call further hearings on his interest disclosure bill, but as far as can be determined the Senate Banking and Currency Subcommittee considering the measure is not disposed to approve it.

Federal charters for mutual savings banks was, of course, one of the Commission on Money and Credit's recommendations, and its future is very much dependent on the attitude of the President's inter-agency study group.

As you would expect, the A.B.A.'s legislative program is dominated by tax uniformity and dividend and interest withholding. Undoubtedly this emphasis will continue until the issues have been resolved.

Our tax problems have served at least one very useful purpose, and I sincerely hope the experience gained from bankers working in national unison on these important matters will continue to guide our future efforts.

Our spokesmen in the national government cannot do a good job of representing us unless they know and understand our views, and we, in turn, understand their problems. They need and want the opinions of all their constituents.

Members of Congress cannot possibly know how pending or prospective legislation will affect you, your business, and your community - unless you tell them. They do not have expert knowledge of everything upon which they are required to pass judgment, and they particularly welcome the help and advice of those constituents who are well informed on various subjects.

I want to commend all of you because you have had frequent and extensive exchanges of views with your Senators and Representatives on tax uniformity and tax withholding. If the public interest does prevail during the present Congressional debate, it will be through your efforts and those of other bankers who have exercised their responsibility in the same capable manner.