

FROM:  
THE AMERICAN BANKERS ASSOCIATION  
THE NEWS BUREAU  
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LEGISLATIVE PROGRESS REPORT

Address of M. Monroe Kimbrel, Vice President of The American Bankers Association, before the Annual Convention of the Arkansas Bankers Association, Arlington Hotel, Hot Springs, Tuesday Morning, May 22, 1962. Mr. Kimbrel is chairman of the board, First National Bank, Thomson, Georgia.

In 1863, a few months after Abraham Lincoln signed the National Bank Act, he appointed Hugh McCulloch to be the first Comptroller of the Currency. One of Mr. McCulloch's first official acts was to prepare a statement of principles to guide bankers in their operations. In the statement he said: "In business, know no man's politics. Manage your bank as a business institution, and let no political partiality or prejudice influence your judgment or action in the conduct of its affairs. The national currency system is intended for a nation, not for a party; as far as in you lies, keep it aloof from all partisan influences."

This advice is just as sound today as it was 100 years ago. And I am sure you would all agree that our banking system would indeed be in a sorry condition if we considered the political interests of our customers along with their credit ratings when we make loans. I think we bankers can be proud of our record on this point.

However, in the past it has seemed to me that we bankers have followed Mr. McCulloch's advice about aloofness--as the saying goes--out the window. I don't think Mr. McCulloch ever intended to imply that bankers should go off and twiddle their thumbs when Congress was considering banking legislation. Nor do I think he would have suggested that bankers ignore the many agencies and departments in government that have an ever increasing influence on the conduct of banking. This, of course, is supposition on my part because many of the agencies such as the Federal Reserve and F.D.I.C. did not exist 100 years ago.

Fortunately, more and more bankers across the country are becoming increasingly aware of the fact that the banking industry--one of the nation's most regulated industries--cannot afford to ignore the impact that legislation and agency rulings have on banking. Most of us now are starting to realize that aloofness toward banking legislation is, in effect, a neglect of our duties. For, if we are to preserve our banking system, we must be sure that those who regulate our industry have at all times the best information available on all banking matters. This, of course, means maintaining close working relationships with our elected and appointed officials. It means studying the complexities of our legislative processes. It means understanding some of the problems government officials face in sponsoring legislation or administering regulations. It means keeping up-to-date on legislative developments. In the past we have tried to rely solely on the Washington staff of the A.B.A. However, this is a tremendous task. The Executive Council, at the Spring Meeting, unanimously approved a dues increase primarily to provide funds for an enlarged Washington operation. But at the same time it is essential that all bankers take a very active part in legislative matters at state and national levels.

There are more indications every day that bankers are starting to do just that. In fact, if my speaking schedule for this spring is an accurate indication, I would say that interest in banking legislation is now at an all-time high.

The reason for this is obvious. The House of Representatives has passed an omnibus tax bill--H. R. 10650--which, if passed by the Senate, will have a direct influence on the future of banking.

I would like to spend a few minutes discussing this bill, particularly two sections of the bill--Section 8 which deals with taxation of mutuals, and Section 19 which proposes a withholding tax on dividends and interest.

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Since tax uniformity has been one of the goals of The American Bankers Association for some time, let's consider it first.

Finding a starting point for a discussion of tax justice is not easy. I could go back to the legislation passed in 1951 which attempted, but ultimately failed, to impose a fair tax on mutuals. I could talk about the Mason Bill of several years ago which was not enacted. But I think this group knows the background well enough to permit me to skip the preliminaries and get right to the bill that was approved by the House and is now being considered by the Senate Finance Committee.

In January of 1960 all groups representing commercial banking joined forces and decided upon a common objective--remove the tax shelter which mutuals enjoy in the form of a statutory bad debt provision.

After studying the matter, both the President and the Treasury were convinced of the merits of the arguments of commercial bankers, and they supported tax uniformity. We, of course, would be rather naive if we failed to understand another basic reason for the favorable support. That is the Administration needed additional revenues to balance the budget.

Last summer, Congressman Wilbur Mills, chairman of the House Ways and Means Committee, held hearings on the President's recommendations for new tax laws. All the Associations representing the commercial bank viewpoint coordinated testimony. Commercial banking made an excellent showing at the hearings. Mr. Mills put tax legislation at the top of his Committee's agenda when Congress reconvened in January.

I might add at this point that Arkansas citizens have a right to be proud of Wilbur Mills' service to the state and nation. His committee has had to handle a tremendous work load recently, and he has consistently guided its activities with both fairness and skill. Indeed, the entire congressional delegation of this state has established an enviable record.

When Congress reconvened last January, the House Ways and Means Committee was faced with drafting a package bill that would meet several objectives. Other provisions of the bill would restrict tax deductions for expense accounts, increase tax earnings of U. S. subsidiaries, and provide an investment incentive for new plants and equipment. To produce additional revenues to balance the loss resulting from the investment incentive, the bill also would contain a provision which would require banks and other institutions to withhold taxes on dividends and interest.

After considering a number of approaches, the Ways and Means Committee approved a tax provision that would give mutual institutions three alternatives: (1) they could deduct 60 per cent of taxable income to add to their bad debt reserves; (2) they could add an amount sufficient to bring the balance in the reserves for losses on real property loans to 3 per cent of such loans outstanding at the close of a taxable year; or (3) they could deduct an amount necessary to bring reserves to a reasonable amount if they could demonstrate to the Treasury a need for a greater reserve than is permitted under the first two alternatives.

Undoubtedly, most mutuals would select the first alternative and pay taxes on 40 per cent of their income. This tax would amount to roughly 18 per cent of total income, or half of the 35 per cent average tax paid by commercial banks.

The tax bill reported by the Ways and Means Committee was passed by the House March 29 by a vote of 219 to 196.

When the Senate Finance Committee started hearings on the bill, Secretary of the Treasury Douglas Dillon urged that the tax uniformity provision be revised to give mutuals the alternative of paying taxes on 66 and 2/3 per cent of income or making additions to bad debt reserves at the rate of 3 per cent of net loan growth.

The A.B.A. was represented at the Senate Finance Committee hearings by Joseph C. Welman, president of the Bank of Kennett, Kennett, Missouri, and a past

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president of the A.B.A. Mr. Welman, speaking for the A.B.A., said: "the Treasury proposal represents the irreducible minimum of net income which can be taxed and still approach the twin goals of adequate tax revenues and equity among financial institutions."

The A.B.A. spokesman said that in 45 metropolitan areas not one penny of federal income tax was paid by savings and loan associations in 1960. He mentioned a few of the metropolitan areas, including your own Little Rock.

Mr. Welman also told the Committee that his bank with \$13-million in assets paid \$92,391 in federal income taxes for 1960. He said, "This was nine times greater than the total combined federal income tax paid in 1960 by all 126 member savings and loan associations in the state of Missouri. . . . As a matter of fact," he continued, "if you include all the member savings and loan associations in the neighboring states of Arkansas, Iowa, Nebraska, and Tennessee, our small bank would still have paid  $2\frac{1}{2}$  times more federal income tax than the total paid by all of these associations combined."

The Senate Committee has concluded public hearings on the bill and is now working on amendments and its report. The Committee is expected to send a bill to the Senate floor in June.

We feel confident that if any tax bill is passed by Congress this year it will contain a provision taxing mutual institutions. Just how much tax they will have to pay is hard to say at this time, but I can assure you that every possible effort has been made to obtain tax uniformity, and any additional work that has to be done will be done. Speaking for the A.B.A., I want to thank the bankers of Arkansas for the splendid cooperation you have shown throughout this effort, and especially for the fine job you've done of keeping your representatives in Washington informed and interested in this issue.

However, I would now like to turn to another provision of H. R. 10650 and, I might say, one that is viewed with less optimism by The American Bankers

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Association. This provision, Section 19, provides that payers of dividends and interest be required to withhold federal income tax at the rate of 20 per cent.

The A.B.A. has long felt that the government should take all reasonable measures to collect income taxes due on interest and dividends. However, we have also maintained the position that withholding is neither practicable or workable. A system has not yet been devised that will not contribute to confusion and irritation on the part of ordinary taxpayers and which would not impose unreasonable hardships or inequities upon retired persons; widows; charitable, educational, and other tax-exempt organizations; and foreign and local governments. Nor has one been devised that would not be unduly burdensome and costly to banks and other dividend and interest payers.

The A.B.A. and many bankers from all parts of the country have cooperated with the Treasury Department in trying to work out some practical solution. We believe that a sound reasoned approach is the only way to solve anything. However, to date no solution has been found.

The A.B.A. has continually taken the stand that the mass educational program being conducted by the Treasury with the cooperation of the commercial banks, together with the increased use of automatic data processing equipment on tax returns, will substantially reduce the gap between dividends and interest paid and the amount reported.

As you know, The American Bankers Association passed a strong resolution against withholding last October at the Convention in San Francisco. This resolution has been vigorously followed by spokesmen for the A.B.A.

When the tax bill was reported out by the House Ways and Means Committee, we urged the House to strengthen the tax uniformity provision, and we were every bit as vigorous in urging that withholding be completely eliminated from the bill. A proposal to eliminate withholding and the investment incentive provision from the House bill was defeated by a vote of 225 to 190. However, we did not urge defeat

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of the whole bill at that time because we hoped the Senate would strengthen the tax uniformity section and eliminate or drastically change the withholding provision.

I mentioned earlier that Joe Welman spoke for the A.B.A. on tax uniformity before the Senate Committee. He also made a strong argument against withholding. He stressed the severe operating and cost problems which would arise in banks, particularly the smaller banks throughout the country, in dealing with both the government and their customers with respect to savings accounts, government and corporate bonds, trust accounts, and stock transfer and dividend paying operations.

Since witnesses testifying before the Committee were held to a time limitation, Mr. Welman's testimony could not cover all the arguments against withholding that had been prepared by the A.B.A. Consequently, in addition to hitting the main points in his testimony, he obtained permission from the chairman of the Committee to submit a detailed memorandum outlining the A.B.A.'s objection to withholding.

The supplemental testimony and statistics ran a total of 37 pages--too much to be covered here--but here are a few of the highlights:

The case for withholding might be overstated. About 95 per cent of all dividend payments are reported on tax returns and over 65 per cent of interest is reported. About 93 per cent of interest included in information documents is being reported on tax returns.

Evidence indicates that the informational program to educate taxpayers is bringing results and the program should be continued and given a fair trial before being discarded.

Automatic equipment will make it possible for the Internal Revenue Service to spot underreporting.

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Efforts are being made to increase the number of criminal prosecutions in particularly flagrant violations. Widespread publicity of these cases can do much to reduce noncompliance.

Additional progress could be made by placing a direct question about interest and dividend income in the individual tax forms.

Increased complications in our tax laws make self-assessment more difficult.

The government Savings Bond program will suffer.

Withholding will impair the functioning of the government bond market.

Withholding may run counter to our balance of payments efforts because investment in dollar claims will be relatively less attractive.

Mr. Welman also discussed the multitude of problems withholding would create for a trust department of a commercial bank.

If, however, after considering all these objections, the Senate Committee still insists on some form of withholding, the following suggestions were made: (1) make exemption certificates good until revoked by the taxpayer, instead of requiring renewal each year; (2) make exemption certificates available to charities, colleges, and other tax-exempt organizations; (3) make exemption certificates available to tax-exempt organizations and to nontaxable individuals regardless of whether they hold their investments directly or through a trust or other fiduciary relationship; (4) exclude from withholding interest on government and commercial marketable securities, and (5) delay the effective date of any withholding program until January 1, 1964, so banks will have at least a year to prepare for such a program.

Secretary Dillon agreed to accept the first and second of these recommendations in his testimony before the Senate Finance Committee May 10.

I do not have a crystal ball; and I cannot, with any degree of confidence, predict the outcome of the Committee's study. Nor do I know any more than you

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about the future of the whole tax package. I will say that many congressmen have been receiving letters by the thousands against the withholding provision. As you know, President Kennedy discussed this in his press conference May 10. There is a possibility that this provision will be dropped. Then, too, there is the possibility that the entire tax package will be defeated because it is being watered down from so many different angles. However, I don't think this last possibility is likely since the Administration can usually muster more support in the Senate than it can in the House.

The next four weeks will be crucial as far as the tax bill is concerned. We should not miss any opportunities to repeat our views to members of Congress. I also understand the withholding provision will be considered during the first week in June by the Senate Committee. We should renew our emphatic opposition to the provision at that time.

We all hope, of course, that the bill will be as close as possible to the recommendations and suggestions we have made. I don't think commercial bankers ever worked harder for any legislation than they have for this tax bill. For many it was a new education in the legislative process. And having this experience behind them, I feel confident that when future legislative matters come up-- and many are now in the preliminary stages--commercial bankers will not be aloof, but will be right in the middle of the discussions. I believe this new sophisticated posture will benefit the banking industry.

There is one other subject that I would like to mention before I close. That is the rapid growth of credit unions. I realize that competition with credit unions has not been a major problem here in Arkansas. Some recent figures show that credit union shares total only 8/10 of 1 per cent of all savings in leading financial institutions in the state. The figures also show that for every consumer loan made by credit unions commercial banks make 14.

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However, credit unions nationally have increased their share of the consumer loan pie from 4 per cent to 10 in the past 10 years. Credit unions now receive  $2\frac{1}{2}$  per cent of total savings. This has also increased  $2\frac{1}{2}$  times during the last decade.

Since January, the United States Department of Agriculture and Credit Union National Association have been working on plans to promote an expanded system of rural credit unions. They propose to use government funds, influence, and manpower to do this.

There are now over 21,000 credit unions in the United States. They have total assets of well over \$6-billion. This system would become another independent banking system if USDA and CUNA had their way. The original proposal, which received a lot of opposition from bankers, was for the Department of Agriculture to use over  $\frac{1}{2}$ -million to promote rural credit unions. That amount was to come from the tax dollars paid by commercial banks and the rest of the nation's taxpayers. It would be used to promote taxfree competitors.

This reasoning is hard to understand. It not only would be a gross misallocation of government funds; but the plan, if implemented, would have been in gross violation of the public interest.

The big problem in agricultural credit, as you well know, is not the need for a larger number of small lenders. The need is for more funds to cover larger loans needed by our more progressive farmers.

The USDA-CUNA plan would work against that goal by oversaturating rural areas with too many financial institutions--each existing one being immediately weakened and its future growth and ability to serve seriously impaired.

Many banks are now forced to go to correspondent banks and in some cases insurance companies to cover credit requests from the larger farms. The growth of credit unions will only aggravate the situation by spreading available deposits over a wider range of lenders.



Other competitors, particularly PCA's, would also be adversely affected. In several cases, they have not yet gained enough strength to repay the government capital which subsidizes them. Additional rural credit unions would forestall the day when these PCA's repaid government capital now invested in them.

The question is not whether credit unions will provide serious competition for Arkansas banks--but when and to what extent. Only you bankers can determine the answer. Certainly, you will not be able to ignore credit unions in the future as you have in the past. I think the time has come for all bankers to consider the long-range competitive threat that credit unions pose. It is not too late for you to examine your inventory of retail banking services and make sure that you are doing everything possible to meet the needs of customers--needs that might otherwise be served by credit unions.

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