

FEDERAL RESERVE BOARD

WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7194

July 1, 1932.

SUBJECT: Reimbursement of Par Remitting Banks for Tax on
Remittance Drafts.

Dear Sir:

There are inclosed a confirmation of a telegram on the above subject which the Board is sending today to the Governor of each Federal reserve bank and a summary of the replies received from the various Federal reserve banks as a result of the Board's telegram of June 23, 1932, on this subject.

It appears that the Governors of one or two Federal reserve banks expect that the Federal Reserve Board will issue a regulation on this subject; but this is not believed to be necessary, as the subject of par collections is adequately covered by the provisions of Regulation J (especially the last paragraphs of Sections II and III) and the fact that the tax is levied on the drawers and not on the payees of checks and drafts clearly appears from the provisions of Section 751 of the Revenue Act of 1932 and Chapter IV of Regulations 42 of the Bureau of Internal Revenue.

It is not believed that any public announcement on this sub-

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ject is desirable; but it is suggested that the matter be taken up individually with each bank which attempts to deduct the amount of the tax from its remittance drafts or which requests the Federal reserve bank to reimburse it for the amount of the tax and that the Board's position on the subject be explained to it. If any bank insists on deducting the amount of the tax from its remittance drafts after the Federal reserve bank has exhausted every reasonable means of persuading it to desist from doing so, the matter should be reported to the Federal Reserve Board, if the bank is a member bank, or the bank should be removed from the par list, if it is a non-member bank.

In the light of the experience which various Federal reserve banks have had in recent years in connection with the removal of non-member banks from the par list, it is not believed that the policy outlined in the Board's telegram will result in any material impairment of the par collection system.

Very truly yours,

Chester Morrill,
Secretary.

Inclosures.

TO GOVERNORS OF ALL F. R. BANKS.

C O P Y

X-7194-a

July 1, 1932

YOUNG BOSTON	HARRISON NEW YORK	NORRIS PHILADELPHIA	FANCHER CLEVELAND
SEAY RICHMOND	BLACK ATLANTA	MCDUGAL CHICAGO	MARTIN ST. LOUIS
GEERY MINNEAPOLIS	HAMILTON KANSAS CITY	McKINNEY DALLAS	CALKINS SAN FRANCISCO

Replies to Board's wire June 23 re absorbing tax on remittance drafts for cash letters discloses that seven reserve banks oppose the absorption of such taxes, three favor it, and the positions of two are doubtful. Board is of opinion that, as matter of System policy, reserve banks should not reimburse remitting banks for tax on remittance drafts. Tax levied on drawers of drafts and should not be absorbed by Reserve Banks for same reasons that they should not absorb any other taxes levied on member or nonmember banks. In view of reasonableness of this position and fact that amount involved for each remitting bank is very small, believe no great difficulties should be encountered and that very few, if any, withdrawals from par list should result if situation is explained properly to banks raising the question. Experience of one reserve bank of which we have already been advised supports this belief. Law and regulations require member banks to remit at par for checks forwarded to them for collection by reserve banks and latter are forbidden to receive for collection checks on nonmember banks which cannot be collected at par. Deduction of tax from remittance drafts is not par remittance. Letter follows.

MORRILL

X-7194-b

SUMMARY OF VIEWS OF FEDERAL RESERVE BANKS RE ABSORPTION
OF TAX ON REMITTANCE DRAFTS FOR CASH LETTERS.

The following is a summary of the replies of the various Federal reserve banks to the Board's telegram of June 23, 1932, inquiring whether, in view of the uniform practice of the Federal reserve banks absorbing certain costs in connection with the par collection of checks, such as those involved in shipments of cash by member banks in settlement of cash letters, the Federal reserve banks, as a matter of system policy, would now be justified in reimbursing member and nonmember banks for the 2¢ tax on drafts sent in remittance for checks and drafts forwarded to them for collection or payment by the Federal reserve banks under Regulation J.

BOSTON No

NEW YORK No

PHILADELPHIA No. Would be illogical and would establish bad precedent. In view of possibility of withdrawals from par list, suggest that no announcement of policy be made "until after regulations have been issued and subject clarified".

CLEVELAND Yes. Strongly recommends adoption of uniform system policy of absorbing tax on all remittance drafts. Refusal to do so would encourage removal of nonmember banks from par list, thus impairing efficiency of check collection system. Many member banks have requested Federal reserve bank to accept their advice of credit as payment

for cash letters in order to escape tax and this would be a step backward because of tendency to change agency relationship which all Federal reserve banks have tried to strengthen and preserve. If reserve banks absorb tax on remittance drafts, all incentive to adopt subterfuges to avoid the tax will be removed and efficiency of check collection system preserved.

RICHMOND.

No. Do not believe it good policy to absorb any kind of tax and it is not correct in principle.

ATLANTA.

Doubtful. Amount involved in absorbing tax by reserve bank of Atlanta would be small - only about \$3750 per year. As matter of policy would be entirely willing to absorb this cost. Doubt remains as to whether as matter of policy we should pay this tax for member and nonmember banks, since under Federal Reserve Act we are exempt from Federal taxes and it might be bad policy in the face of such exemption for us to voluntarily absorb any taxes. My personal opinion in view of this doubt is that tax probably should not be absorbed. However if system policy is adopted of absorbing such taxes this bank will readily acquiesce.

CHICAGO.

No. Drawer of checks should pay tax on remittance drafts.

ST. LOUIS.

Yes, if matter develops so as to jeopardize par list. Requests so far in Eighth District not sufficient to justify serious consideration from standpoint of effect on par list. Uniform action throughout System essential.

- MINNEAPOLIS.** Yes. Inclined to think it would make better feeling among banks, especially nonmembers, if we were to absorb the tax. If we do not some nonmember banks will withdraw from par list. Already assume shipping charges on currency and wire costs on transfers and 2¢ additional would be small item.
- KANSAS CITY.** No. If reimbursement were made to member banks it would serve to diminish Federal revenue by reducing amount of franchise tax paid by reserve banks.
- DALLAS.** No. Congress has attempted in the new tax bill to make an equitable distribution of the tax burden, basing it upon business activity and other considerations and has specifically provided that the maker or drawer of a check or draft should pay the tax thereon and it is our thought we should no more absorb that item than we should a portion of a member banks other taxes. If we should reimburse the banks the expense would be absorbed out of funds that might otherwise be paid to treasury as franchise tax at end of year and thus the very purpose of the Revenue Act to that extent would be defeated. Aside from this, we are rendering very substantial amount of free service to member banks and we do not believe that in all fairness we are warranted at this time in increasing the amount of expense absorbed by us. We have not had and do not anticipate having any

(Dallas, continued)

serious difficulty in this connection. A few banks deducted the tax from their first remittances but, upon our advising them with reference to the law, they readily agreed with our position and have not repeated the deduction. This is true of both member and nonmember banks.

SAN FRANCISCO. Position doubtful. Telegram of June 20 said Federal Reserve Bank of San Francisco would not absorb tax, but telegram of June 23 says, Reserve bank is now in receipt of drafts issued by member and non-member banks in settlement cash letters sent to them from which remitting bank has deducted 2 cent tax on covering draft. It would seem that absorption of this charge by Reserve Bank would ultimately come out of public treasury through lessening of profits which may hereafter inure to government. Any ruling by commissioner Internal Revenue to effect that deduction of tax by remitting bank would nullify law and therefore prohibited would cause banks having accounts with reserve bank to discontinue use settlement drafts and adopt practice of giving credit advices. From standpoint check collections, use of credit advices is extremely dangerous; because it would set up debtor and creditor relationship which System has taken great pains to avoid. Counsel of opinion that Commissioner Internal Revenue may rule that drafts issued to Reserve Banks in settlement cash letters not subject to tax. If nonmember

banks insist upon deducting tax, reserve banks have
no alternative but to pay or open wide whole par
collection question.

WW/sad

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