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REVENUE ACT OF 1962

1498—

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 10650

AN ACT TO AMEND THE REVENUE ACT OF 1954 TO PROVIDE A CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY, TO ELIMINATE CERTAIN DEFECTS AND INEQUITIES, AND FOR OTHER PURPOSES

APRIL 11, 12, AND 13, 1962

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REVENUE ACT OF 1962

WEDNESDAY, APRIL 11, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:15 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Long, Anderson, Douglas, Gore, Hartke, Williams, Bennett, Curtis, and Morton.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. M. Woodworth, of the Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

The first witness is Joseph Welman, of the American Bankers Association. Come around and take a seat.

STATEMENT OF JOSEPH C. WELMAN, PRESIDENT, BANK OF KENNETT, KENNETT, MO., APPEARING ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION; ACCOMPANIED BY CHARLES WALKER, EXECUTIVE VICE PRESIDENT OF THE AMERICAN BANKERS ASSOCIATION; AND CHARLES McNEILL, DIRECTOR OF THE WASHINGTON OFFICE OF THE AMERICAN BANKERS ASSOCIATION

Mr. WELMAN. Mr. Chairman and gentlemen of the committee, thank you very much for the privilege of appearing before you today.

My name is Joseph C. Welman. I am president of the Bank of Kennett, Kennett, Mo., and I am a past president of the American Bankers Association.

My bank is a small country bank, with total assets of $18 million and located in a town of 9,000 people. I am appearing today to present the views of the American Bankers Association on H.R. 10650, the Revenue Act of 1962.

Our association represents 18,142 commercial banks, or 98 percent of all commercial banks in the country. I might note that the great majority of commercial banks are of relatively small size, with four-fifths having less than $10 million in deposits.

I have accompanying me and I should like to present Dr. Charles Walker, executive vice president of the American Bankers Association and Mr. Charles McNeill, director of the Washington office of the American Bankers Association.

Senator ANDERSON. Did you say you were not now president of the ABA?

Mr. WELMAN. No, sir; I am a past president.
Senator ANDERSON. How far past?
Mr. WELMAN. 1957, 1958.
Senator ANDERSON. Who is the present president?
Mr. WELMAN. Mr. Sam Fleming of Nashville, Tenn.
Senator ANDERSON. How large is his bank?
Mr. WELMAN. I think, sir, it is about $200 million.
Senator ANDERSON. Is there any significance in the fact they picked out a rather small bank to present the attitude of rather large banks?
Mr. WELMAN. I don't know, sir.
Senator ANDERSON. It is a good psychology problem.
Mr. WELMAN. Perhaps so.

This bill reflects a great amount of dedicated effort on the part of many persons. Although there are sections which we believe should be amended, we commend the members of the House Ways and Means Committee, and the other individuals and agencies concerned, for the work which has been done.

I will direct my remarks to the two sections of H.R. 10650 which are of particular interest to commercial bankers: first, section 19, dealing with tax withholding on dividends and interest; second, section 8, dealing with the proposed taxation of savings and loan associations and mutual savings banks.

With respect to the latter section, I should point out that representatives of the five banker organizations which will be heard on this issue have divided the subject matter so that your committee may have before it, at the conclusion of the testimony, the full story with respect to taxation of the mutual institutions.

Mr. Albig, representing the Independent Bankers Association, will discuss this matter with primary reference to community banks; Mr. Stoddard, representing the Roth committee, will analyze the effect upon housing of the taxation of mutual institutions; Mr. Tark, representing the Bankers Committee for Tax Equality, will discuss the appropriateness of the bad-debt formula provided for in this bill; and Mr. Freeman, representing the Association of Reserve City Bankers, will summarize the commercial bank position on section 8 of this bill.

SECTION 19

The American Bankers Association fully recognizes the imperative necessity of reaching all taxable income and the fact that some interest and dividends are now unreported and escape taxation.

We believe that all reasonable measures should be taken to collect income taxes due on interest and dividend receipts.

However, we do not believe that it has been demonstrated that the withholding proposal incorporated in section 19 is the necessary or best means of accomplishing this result at this time.

The association believes failure to report interest and dividends is, in most instances, not deliberate; that such failure arises through misunderstanding of the law or inadvertence on the part of taxpayers.

Most savings account depositors in commercial banks and most shareholders in mutual financial institutions elect to have their interest or dividends retained in their accounts rather than paid to them. In this manner they augment their savings. It is quite easy, therefore, for some of them to overlook reporting this type of income.

As Internal Revenue Commissioner Caplin pointed out recently during a television appearance, "much" of the Treasury's loss of revenue in this area is "due to sheer ignorance."

The American Bankers Association believes that the problem can largely be solved by education. Consistent with this view, the American Bankers Association, the State bankers associations, and other associations representing payers of interest and dividends have cooperated with the Treasury Department by urging their members to notify their depositors and shareholders that interest and dividends paid or credited constitute taxable income and should be reported.

This educational program was started early in 1960 and continued in 1961 and 1962.

Results of an educational program of this kind are necessarily cumulative, and we are convinced that this program will substantially reduce the failure to report and the consequent revenue loss.

We earnestly believe that your committee and the Congress should have the benefit of the results of several years of the educational program before forcing the financial community and millions of taxpayers to adjust to the complicated requirements of interest and dividend withholding.

Another development which should lead to substantial improvement in the reporting of interest and dividend income is the application of automatic data processing, which Internal Revenue is now putting into operation.

Our association supported the Treasury's request for legislative authority to provide account numbers to taxpayers, and we are also cooperating in putting such an account numbering system into effect.

This will be a costly and time-consuming operation for banks and other payers of interest and dividends, but we do not question the need for it. We believe, however, that automatic data processing, together with taxpayer account numbers, will enable Internal Revenue to make effective use of information returns, supplied by payers of interest and dividends, and that such use will obviate the need for withholding.

Withholding will create severe operating and cost problems for the 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.

In addition, taxpayers will encounter difficulties in complying with this intricate system.

Of even greater significance are the hardship for savers, holders of Government and corporate bonds, beneficiaries of trusts, and shareholders of corporations which would result from overwithholding.

A detailed statement setting forth the position of the American Bankers Association is being prepared, and I request the permission of the chairman to submit this statement for insertion in the record at the time that your committee hears witnesses testifying on section 19 of this bill.

The CHAIRMAN. Without objection the insertion will be made at the time section 19 is considered.

Mr. WELMAN. To summarize, the American Bankers Association believes that taxpayer education combined with the use of automatic

data processing and other measures available to the Treasury will close the reporting gap without subjecting millions of individuals to the many difficulties and hardships resulting from a cumbersome withholding system.

Senator LONG. Might I ask a question at that point, Mr. Chairman?

The CHAIRMAN. Senator Long.

Senator LONG. Might I ask whether you people might not be able to come up with a proposal of your own as to a way that this thing could be administered without the kind of burden that you anticipate on the banks? The kind of thing I have in mind is perhaps before you ever compute what the interest will be on each, what the tax will be on interest on each account, that you just take your overall amount that is going to be paid on interest and make, let us say, a 20-percent deduction and then have the account reflect what the payment is after interest has been withheld on everything.

So doing that you would be in position of having made a single adjustment. Then one would just put an asterisk on a receipt that you send to him on any interest payments. They have 20 percent coming to them and let them worry about getting that with the internal revenue collector.

That is just one thought that occurred to me, but have you people undertaken to study all alternatives along that line or would you say that this might be handled with a minimum burden on the banks?

Mr. WELMAN. Yes, sir, Senator.

The association has been working with the Treasury Department. We have had numerous conferences and numerous committee meetings in an attempt to find all of the means we can to make withholding simpler if it is adopted, and what you are saying is, of course, a provision in the bill.

We can't, however, avoid the necessity of computing the interest on each individual savings account. It eventually has to be entered in their books and many of us, particularly in the small banks, believe we are dutybound, even if not legally so, to inform the depositors of the deduction and the amount of the gross interest and the amount deducted, and I suspect we will probably do that.

Senator LONG. Well, the thought occurs to me in the absence of anybody doing anything about it if I have an account in that bank for my daughter, that your statements in the absence of any application on her part for a refund, would entitle her to a tax credit.

Mr. WELMAN. Yes, sir.

Senator LONG. In the amount of 20 percent of everything paid her on interest during the period of time that that money had been withheld by the Government. The money is on saving anyhow and on behalf of my daughter I am not going to apply for that providing we don't lose the money by not applying.

It is a savings that is there as far as I am concerned, I am satisfied with the Government owing it to me, providing the fellow is there when the time for payment comes, and it——

Mr. WELMAN. I think we are more concerned with the question of overwithholding than with those who may owe that much or more tax.

We think we still will have the problem of advising all of our 52 million savers in the commercial banking system of this deduction.

In addition, we would still have the problem of the gross-up that is contemplated in the various proposals which would cause much confusion to many of them, and since they will only receive a net credit on their book they will have to compute what the gross interest was.

Senator LONG. The thought that occurs to me instead of giving 4 percent that you might give, let's say, 3.2 and as far as you are concerned the other eight-tenths of 1 percent could be taken out before you ever start computing on the individual account at all.

It is taken off the gross.

Mr. WELMAN. Taken off a net rate?

Senator LONG. Yes.

If you are going to pay on 4 percent just make a simple calculation and take out 20 percent, then you are paying on 3.2.

Mr. WELMAN. Of course, we will be paying on various rates. Some savings accounts are 3½ and some are 4, and it will be complicated. There will still be some exemption certificates.

Senator LONG. If you bunch them up you are still making 2 computations instead of 200,000.

Mr. WELMAN. Approximately 15 percent of our savers in the commercial banking system will be minors and they will be able to file an exemption certificate.

Senator LONG. You can do it that way. What I am talking about is there are other ways of doing it instead of computing on each account. You could simply have it so that you take out what the withholding is before you ever make the next computation.

So far as a minor is concerned any minor who has a saving account in that bank does not represent a person who has an income that he has to spend in the next quarter and the result would be for the Government merely to owe the money to them.

Mr. WELMAN. We are very much interested in working with the Treasury in any way we can to make this chore easier and to accomplish the collection of tax. We just feel that this particular proposal is very burdensome and we unfortunately have no good alternative to offer to them.

We are exploring every possibility of it.

Senator LONG. If you become convinced this proposal is going to become law I hope you will put your best minds to work in administering it in the best way.

Mr. WELMAN. I assure you we will.

We believe, therefore, that legislative action is not necessary at this time.

If, however, your committee and the Congress should conclude that withholding on dividends and interest is necessary at this time, we suggest certain amendments to H.R. 10650 which we believe would be helpful in reducing the problems and expense of such a system.

These amendments, several of which I shall mention briefly, will be covered in detail in the supplemental statement to which I referred which will be submitted for insertion in the record when section 19 is under consideration.

First, the bill provides that exemption certificates filed on the basis of nonliability for tax must be renewed each year; we strongly believe that such certificates should be good until revoked by the taxpayer.

Otherwise, the burden of administration would be significantly increased.

Second, we suggest that the provision of the bill which permits individuals to file exemption certificates for dividend income be broadened to include charities, colleges, and other tax-exempt organizations.

Third, we believe that exemption certificates should be made 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.

If corporate fiduciaries and other trustees could be authorized by Treasury regulations to file exemption certificates with payers of interest and dividends, the trustee could act as withholding agent in each case and remit to the Treasury on behalf of taxable beneficiaries but provide for full exemption for nontaxable individuals or tax-exempt beneficiaries.

Fourth, inasmuch as institution of a comprehensive withholding system will be a complicated and time-consuming operation, we believe that it is essential that a reasonable time be afforded before withholding would become effective.

If this section should become law, many of the equipment and personnel changes could not be made until regulations were issued by the Treasury spelling out certain withholding requirements.

Payers of interest and dividends would need at least 1 full year to prepare for withholding. We therefore urge that the effective date for section 19 should be not earlier than January 1, 1964.

In this connection, we note that commercial banks and other financial institutions will incur substantial expenses this year in preparing their records to include account numbers for income tax reporting purposes.

These amendmetns would ease to some extent the burdens which withholding would place upon the payers of interest and dividends. However, their adoption would not remove the basic difficulties inherent in the withholding proposal, nor would it alter our original conclusion that withholding is neither the necessary nor the best method of accomplishing the objective of complete reporting of interest and dividends.

Section 8 of this bill removes the virtual exemption from Federal income taxes now enjoyed by savings and loan associations and mutual savings banks and substitutes instead of formula which would tax, at a maximum, 40 percent of the net income of these institutions at regular corporate rates.

While the American Bankers Association believes that such a provision is a definite improvement, we are nevertheless firmly of the opinion that this measure falls far short of the goals of removing tax inequities and of providing adequate tax revenues from mutual savings banks and savings and loan associations.

This mutual savings industry is large; and rapidly growing larger. Its total assets at the end of 1961 were $125 billion.

It had total savings of $109 billion, far more, incidentally, than the $76 billion of savings and time deposits (excluding Government and interbank deposits) held by commercial banks.

Savings and loan associations have increased their total assets 327 percent over the past decade; mutual savings bank assets have risen 88 percent.

In contrast, commercial bank assets have grown during this period by only 52 percent. In short, the mutual savings industry is neither underprivileged nor struggling, and there is no reason why it should continue to escape its tax responsibilities.

Under existing law, savings and loan associations and mutual savings banks pay only a negligible amount of Federal income tax. While you are aware of the tax shelter enjoyed by the mutual institutions, perhaps a few illustrations might be helpful.

In 1960, the 4,700 savings and loan associations which are members of the Federal Home Loan Bank system reported a net income after the payment of dividends of $564 million, but paid Federal income tax of only $4 million, or seven-tenths of 1 percent of net income.

Insured mutual savings banks had net income of $169 million in 1960, but paid Federal income tax of only $447,000, or about one-quarter of 1 percent of net income. This contrasts sharply with the commercial banks, which in 1960 paid $1.3 billion in Federal income taxes on a net income of $3.8 billion.

Senator LONG. Let me ask this question if I might.

Mr. WELMAN. Yes.

Senator LONG. What, if any, is the reason for distinction of the two types of taxation? Does the Federal home loan system stand on any basis, a a taxpayer, different from the commercial banks?

Mr. WELMAN. The difference, sir, is, of course, in reserves for bad debts that have been permitted in the past. That of the mutual savings institutions being 12 percent of their share accounts or deposits which has provided virtually complete tax exemption for their net income, whereas commercial banks have about a 2.4-percent bad debt reserve on uninsured loans permitted them on the average.

Senator LONG. How do the losses compare on the two? Are their losses higher than yours?

Mr. WELMAN. No, sir; we don't think so. I think the figures will appear in our supplementary memorandums.

Senator LONG. All right.

Mr. WELMAN. The extent of the mutual's tax advantage is perhaps more readily seen in figures for individual cities.

For example, not one penny of Federal income tax was paid in 1960 by any member savings and loan association in Richmond, Va.; New Orleans, La.; Miami, Fla.; Topeka, Kans.; Nashville, Tenn.; Augusta, Ga.; South Bend, Ind.; Little Rock, Ark.; Duluth, Minn.; Wilmington, Del.; or Louisville, Ky., to mention only a few of the 45 major metropolitan areas in which this was the case.

In most other metropolitan areas the average tax paid by each member association was negligible.

For example: In Oklahoma City, the average tax paid by member associations was $182; in Salt Lake City, $6,500; in Omaha, $429; in Chicago, $188; and in Baltimore, $580.

Perhaps the best illustration which I can give of the favored tax position of the mutual institutions is one based on my own experience.

My bank is, as I noted, a relatively small institution with $18 million in assets. In 1960, we paid Federal income tax of $92,391.

This tax was 9 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, though these associations had combined savings of $1.4 billion and net income after dividends of more than $14 million.

As a matter of fact, 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 2½ times more Federal income tax than the total paid by all of these associations combined.

The reason the mutual institutions pay only negligible taxes was the inclusion, in 1951, of a provision in the revenue act of that year, permitting them to transfer tax free to bad debt reserves all income remaining after the payment of dividends so long as their total reserves, surplus, and undivided profits do not exceed 12 percent of share accounts or deposits.

That is the point that you asked about, Senator. This 12-percent limit is not predicated upon loss experience nor upon the amount of risk assets, but, instead, applies to total share accounts or deposits. It permits the mutual institutions to treat virtually all of their net income as tax-free additions to reserves and thus provides a major tax shelter for one of the most profitable and fastest growing industries in the United States.

Senator ANDERSON. Could I ask a question there?

Mr. WELMAN. Yes.

Senator ANDERSON. If you did not allow the building and loan association to transfer this 12 percent to reserves, it would be available for dividends; wouldn't it?

Mr. WELMAN. A certain portion.

Senator ANDERSON. What do you mean by "a certain portion"?

Mr. WELMAN. Well, I think, of necessity, with supervision of the sort they have, they would have to set aside some of it.

Senator ANDERSON. That is what I was going to ask you. If you want to free them all why don't you also provide that they can also pay all of this out in dividends, the maximum amount in earnings? As I understand it, the Federal Government wouldn't let them pay more than a certain amount because the banks don't like that kind of competition; isn't that right? They can pay all of it.

Mr. WELMAN. There are perhaps some regulations for a minor portion of it to be withheld for bad debts.

Senator ANDERSON. I bring you bad tidings. I am told they are not allowed to pay out more. If you have other information, I would like to have it because we have some building and loans in my hometown. I don't happen to have any interest in any of them so I can speak very freely.

The big Albuquerque Federal Savings & Loan has deposits, I think, of $50 million; there are three fair-sized banks in our community, I think the Albuquerque Federal Savings & Loan retains more profits than all of them—all of the three put together and probably a good many others.

But they now have a dividend, I think, of some kind, of 4½ percent, if they didn't have this they might go up to 5.

Do you think the Federal Government would permit them to go up to 5?

Mr. WELMAN. Could I refer this question to Mr. McNeill who is more familiar with the technical details as to what they are permitted?

Senator ANDERSON. You can refer it to anybody you want to. All I am told is that the building and loans are told that the Federal of Albuquerque was setting the policy and they couldn't pay more even though they wanted to pay more.

Mr. WELMAN. Would you answer that, Mr. McNeill?

Senator ANDERSON. I just want to know if the bank earnings position is you would have to have this 12 percent made available for dividends, you would have no objection no matter how large the dividend went.

Mr. MCNEILL. Senator Anderson, as a matter of law I think it is clear that the Federal savings and loan associations are not limited in the amount they can pay out.

Senator ANDERSON. I didn't say as a matter of law. As a matter of regulation they are, aren't they?

Mr. MCNEILL. Not as a matter of regulation; no, sir.

Senator ANDERSON. What keeps them from it?

Mr. MCNEILL. Their own business management, knowing what they can pay.

Senator ANDERSON. Pardon me for 1 minute.

Are you telling us here the Home Loan Bank, that the bank over in Little Rock, doesn't tell the bankers association in Albuquerque how much they can pay out?

Mr. MCNEILL. They make recommendations and suggestions but they have no authority by law or regulations.

Senator ANDERSON. And those regulations have the force of law?

Mr. MCNEILL. They haven't so far, sir.

Senator ANDERSON. Can you name any building and loans that are violating the instructions of the Federal Reserve group?

Mr. MCNEILL. They are not violating instructions. Suggestions have been made that appeared in the press on frequent occasions that the Home Loan Bank Board did not like to see dividend rates of the savings and loan associations increasing. But you have seen reports in the press on frequent occasions, particularly from the west coast, and in the local area, increases of a quarter and a half percent within the last few months.

Senator ANDERSON. Then the American Bankers Association would have no objection to taking this 12 percent and paying it out in dividends?

Mr. MCNEILL. Senator Anderson, we don't believe that would be the result. As a matter of sound management——

Senator ANDERSON. What would you do, just leave it there to be taxes? As long as it is paid out in dividends you can't tax 52 percent of it.

Mr. MCNEILL. They also have to have sound management to run a sound institution.

I wouldn't want them to endanger the safety of their associations by paying it all out in dividends.

Senator ANDERSON. Which side are you on? Do you want it kept in there for safety or do you want it taxed out?

Mr. MCNEILL. Some has to be retained but we say that can be done after payment of taxes, sir.

Senator ANDERSON. You want to tax the whole amount that is available for dividends?

Mr. McNeill. No, sir.

Senator Anderson. But this reserve is available for dividends.

Mr. McNeill. No, sir. Whatever amount is retained after a reasonable bad debt reserve, however, that reserve is determined, there also should be a further retention, but that can be done after payment of Federal income taxes.

Senator Anderson. Two percent would be sufficient, wouldn't it?

Mr. McNeill. The Treasury report to the Ways and Means Committee indicated that they considered an adequate bad debt reserve on the basis of experience would be somewhere between 2 and 3 percent.

Senator Anderson. Well, I didn't know that. I just guessed 2 percent would be sufficient.

Now, they have 12?

Mr. McNeill. The Treasury estimated an average of about 2½ percent overall.

Senator Anderson. If they have 2 percent and they put that, and they have 12 you wouldn't mind the other 10 percent being put out in dividends?

Mr. McNeill. They would be able as far as the law is concerned, if they decided.

Senator Anderson. I didn't say able to, would you mind them doing it?

Mr. McNeil. No; we wouldn't like that.

Senator Anderson. That is all I want to get at.

Mr. Welman. The mutuals, like other businesses, should be permitted an adequate bad-debt reserve to which reasonable additions can be made, tax free; they should, like other businesses, provide for the remainder of their surplus and reserve needs out of after-tax income.

The bill would permit them to choose between adding to bad-debt reserves in each year an amount equal, in effect, to 3 percent of their net loan growth or 60 percent of their net income.

Even though the 3 percent of loan growth is more than can be justified by industry experience (and, incidentally, is more than is permitted the average commercial bank), it is apparent that most institutions will choose to be taxed on the still more favorable basis of 40 percent of net income.

The allowance of 60 percent tax-exempt income as provided in this bill has no relationship to the adequacy of bad-debt reserves, nor is it predicated upon actual loss experience.

To illustrate, if this bill had been law in 1960, member savings and loan associations could have placed $338 million to reserves tax free, yet their net losses were less than $10 million.

Similarly, insured mutual savings banks could have placed 101 million tax-free dollars to reserves for bad debts in 1960, yet their net losses during the year were less than $2 million.

At present growth rates, the mutual institutions in the first 2 years of taxation under this bill would be able to make tax-free additions to reserves of approximately $1.2 billion, an amount which would substantially exceed the total losses taken by all operating and failed savings and loan associations and by all operating and closed mutual savings banks for the last third of a century, including the entire period of the great depression.

Although there can be no justification for tax-free loss reserves of this magnitude, one argument is nevertheless advanced to justify the formula now contained in section 8.

It is claimed that to subject the mutual institutions to fair taxation might cause them to reduce dividend rates and thus reduce the flow of funds to the mortgage market, in which they are major lenders.

This argument is not valid. Because of the rapid growth in net income of the mutual institutions, there is little reason to expect a downward adjustment in dividend rates if an equitable tax formula were adopted.

This was pointed out, for example, in a recent Treasury statement to Representative Keogh, at which time it was also noted that even if taxed the rising net income of these institutions would permit many to continue to raise dividend rates.

Certainly, taxation will have some impact on the mutual institutions; it has an impact on any profitmaking business, but we doubt that most mutuals will reduce dividend rates as a result of being taxed.

Second, with respect to the housing issue, it is notable that there is neither a present nor anticipated shortage of housing funds.

The Housing and Home Finance Agency has estimated that during the decade of the 1960's the supply of funds available for housing will exceed the demand by more than $20 billion.

Even savings and loan spokesmen have expressed concern over the fact that they have not been able to find a sufficient volume of mortgages in which to invest their funds.

This is reflected in reports of the Federal Home Loan Bank Board which indicate that for much of the past year savings and loan associations have been investing an increasing proportion of their savings in loans for purposes other than the purchase or construction of homes.

There is, in fact, no reason to be concerned over housing if this prosperous mutual savings industry pays its fair share of taxes.

Certainly, other businesses are able to serve the needs of their customers and still pay taxes. I am confident that an industry as large and as vigorous as the mutual savings industry will be able to pay taxes and prosper.

In short, the housing argument is nothing more than an attempt to frighten the public and the Congress into permitting the mutual institutions to continue to enjoy almost complete freedom from Federal income taxes.

It is an emotional argument which is dissipated when the facts are examined. It should not divert attention from the real question, which is: The amount of tax which should reasonably be paid by a $125 billion industry.

An equitable tax formula would provide that the mutual institutions be given no greater bad-debt allowance than can be justified to the Treasury on the basis of loss experience.

In our opinion a bad-debt formula so determined probably would not differ significantly from that now applicable to the commercial banks.

However, determination of the formula should be a matter for the Treasury and the mutual institutions to work out, and we could not object if the mutual institutions were able to justify, on the basis of

experience, more favorable reserve allowances than are now permitted the commercial banks.

As noted previously, the bill provides that the mutual institutions may elect each year to have their bad-debt reserve allowance based on either 3 percent of loans or 60 percent of net income.

We have no particular quarrel with the 3-percent-of-loans approach, although it appears to us to be more than experience would jusify.

However, to permit 60 percent of income to go tax free to reserves and tax only 40 percent of income is clearly inappropriate.

There is no question that if nondiscriminatory tax treatment is to be obtained in accordance with President Kennedy's recommendation a larger percentage of the mutual institutions' net income should be taxed.

We note that in his testimony before your committee last week Secretary Dillon suggested that taxation of two-thirds of the mutuals' net income, after payment of dividends, would be a more equitable approach.

We agree with this conclusion and regard his recommendation as a significant improvement over the formula now incorporated in the bill.

The Treasury proposal, as the Secretary noted—

> would permit tax-free additions to reserves of amounts well in excess of bad-debt reserve needs and would allow, in effect, substantial tax-free additions to capital.

It is clear, therefore, that the formula proposed by the Treasury, while approaching tax uniformity, is nevertheless still quite favorable to the mutual institutions. We believe that it 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.

This, gentlemen, concludes my formal statement and I would like to request permission to submit several supporting memorandums and tables to be included in the record with my testimony. These memorandums and tables cover, respectively, annual loss data of commercial banks and mutual savings institutions from 1930 to 1960, the analysis of the effect of availability of mortgage funds of the taxation of mutual savings institutions, and Federal income tax paid by Federal Home Loan Bank members and loan associations in metropolitan areas in 1960.

The American Bankers Association is also interested in section 3 of the bill relating to the allowance of reductions for income tax purposes of expenses incurred in making appearances, submitting material and communicating with respect to legislative matters and I request permission to submit a separate statement in the record setting forth the association's position in support of this section.

The CHAIRMAN. Without objection.

Mr. WELMAN. Yes, sir.

Senator LONG. Do I understand that these statements will be printed in the record?

The CHAIRMAN. Yes.

Senator ANDERSON. Will we have a chance to come back and question them on them?

Suppose he files a statement saying lobbying is a wonderful institution. Would we be able to question him?

The CHAIRMAN. Do you want him to come back later on?

Senator ANDERSON. I think we ought to have the opportunity of having him come back.

The CHAIRMAN. I am certain he would be glad to come if the committee desires him to come and if Senator Anderson wants him to come.

Senator ANDERSON. Why did you leave it out?

Mr. WELMAN. I have it here.

Senator ANDERSON. Why don't you submit it?

Mr. WELMAN. I will submit it now.

Senator ANDERSON. The lobbying statement?

Mr. WELMAN. May I read it, sir?

Senator ANDERSON. As far as I am concerned, I will be glad to have it.

Would the Chairman object to his reading it?

The CHAIRMAN. I have no objection to his reading it.

Mr. WELMAN. Section 3 of H.R. 10650 amends section 162 of the Internal Revenue Code——

Senator BENNETT. Mr. Chairman, can we identify the location in the statement?

Senator ANDERSON. The very last part, the very last two pages.

Mr. WELMAN. The very last part of the supplementary material.

Senator BENNETT. Oh, yes, thank you.

Mr. WELMAN. Section 3 of H.R. 10650 amends section 162 of the Internal Revenue Code to make it clear that ordinary and necessary expenses incurred in making appearances, submitting material, or communicating with respect to legislative matters at the National, State or local level will be allowed as deductions for Federal income tax purposes and that the portion of dues paid or incurred with respect to any organization of which a taxpayer is a member which is attributable to the expenses of such activities will likewise be deductible by the taxpayer.

Current regulations of the Treasury Department relating to expenses incurred with respect to legislative matters require the disallowance of a deduction for the portion of dues and other payments to any organization, a "substantial part" of the activities of which consist of lobbying to the extent that such amounts are "attributable to" these activities.

The determination as to whether activities of this type are a substantial part of the overall activities of a multipurpose organization is most difficult, as the term "substantial" is a term of uncertain application.

Also, segregating and classifying expenses incurred in connection with such activities present serious difficulties.

The report of the Committee on Ways and Means point out that:

> It is also desirable that taxpayers who have information bearing on the impact of present laws or proposed legislation, on their trades or businesses, not be discouraged in making information available to the Members of Congress or legislators at other levels of government.

The report further states that:

> In many cases making sure that legislators are aware of the effect of proposed legislation may be essential to the very existence of a business.

Therefore, it is the view of the American Bankers Association that this is desirable and needed legislation and is in the public interest.

The CHAIRMAN. Mr. Welman, in your statement you say:

> We believe, however, that automatic data processing, together with taxpayer account numbers, will enable Internal Revenue to make effective use of information returns, supplied by payers of interest and dividends, and that such use will obviate the need for withholding.

Now, I had the privilege of handling the bill that established the so-called numbering process, and I was authorized by the Treasury to say to the Senate that if the bill passed that I could say that it would bring on to the tax rolls $5 billion which is not now taxed, and I am concerned about this particular question as to what extent the numbering process will avoid the withholding.

I would like to ask you, as a representative of the American Bankers Association, when you submit your statement on section 19, to give to the committee your justification for the statement you have made here: namely, that the numbering process, combined with the automatic data processing, will bring about a situation where there will be no evasion of taxes with respect to the banks both in dividends and in interest. As I understand it, of course, you report your dividends now.

Mr. WELMAN. Yes, sir.

The CHAIRMAN. What about the interest, the savings accounts, and so on?

Mr. WELMAN. The interest paid in amounts of more than $600 to any one person or individual are reported, but not below this figure.

The CHAIRMAN. I mean the individual who has a savings account: is that reported, the earnings on that savings account or is it added to the account?

Mr. WELMAN. No, sir; not unless they are more than $600.

The CHAIRMAN. I mean do you make reports now on the interest before it is paid to the owner of the savings account?

Mr. WELMAN. No. Some banks do report to the individual, and some don't. The depositors come in and get the information. But to the Government we report only when the interest amounts to more than $600.

The CHAIRMAN. Well, you think you can sustain by a report in detail your statement here?

Mr. WELMAN. Well, may I say, sir, that our thinking is that we are also relying upon the educational efforts that have been made and are now being made, together with nationwide publicity that has been given to this entire matter of paying on interest and dividends. The various periodicals are now showing pictures of automatic data processing machines; there are a great many articles and discussions on radio and television. The effectiveness of this publicity, together with the automatic data processing and our educational efforts only started in 1960, have not yet been fully evaluated. For example, we don't know the results of the past year or how much improvement there has been.

We believe it is substantial and we believe that cumulative effects of that education along with this automatic data processing and the efforts being made by the Government, the Treasury itself, and the publicity that is nationwide; all of those things combined will go a

long way toward closing the gap between the amount which has been paid and which should have been paid on dividends and interest.

The CHAIRMAN. I am more concerned, not by the propaganda and so forth, but with your statement that you have a system whereby you can report to the Treasury those taxable items, both in dividends and interest, and whereby he Treasury then can take that list and assign it to the numbers and avoid any evasion of taxes?

Mr. WELMAN. It certainly would be far easier for us to report than it would be to go through the withholding exemption certificates and all of the processing necessary in that connection.

We are not now reporting amount of interest paid unless it is more than $600.

The CHAIRMAN. I am not speaking about the $600 figure. If a person has a savings account, is it added to his account or is the money paid to the person who has a savings account?

Mr. WELMAN. It is generally added to the account, Senator, and some banks do require a fee for handling it but it is not reported unless the amount of interest involved is $600 for the year.

The CHAIRMAN. Well, that is taxable under the law when it is added to the account, is it not?

Mr. WELMAN. Yes, sir; that is correct, sir.

The CHAIRMAN. There is no report made of that by the banks to the Internal Revenue?

Mr. WELMAN. No, sir; that is correct.

In my own bank we send each year, at the end of the year or the first month of the new year, a notice to these people calling attention to the fact that the interest that has been credited to their account or paid to them on time or savings deposit is taxable and should be reported. We believe that we are just now beginning to see the effects of that.

The CHAIRMAN. I am not talking about the propaganda, the publicity, or anything else. I am asking you, as a banker, whether you can make such reports to the Internal Revenue that will enable the Internal Revenue to combine this income on the basis of the numbering bill, and thereby not have tax evasion.

Mr. WELMAN. I believe that the American Bankers Association recommends one alternative which would substantially lower this $600 reporting and I don't know that it is——

The CHAIRMAN. The $600, that is one thing. But I am correct in the fact that you do not report the interest?

Mr. WELMAN. That is correct.

The CHAIRMAN. The savings interest?

Mr. WELMAN. That is correct.

The CHAIRMAN. Can you make those reports in such a way that the numbering process will operate and thereby it will be added to the income of the person who has a particular number?

Mr. WELMAN. I should say it would be possible and that it would be preferable to the withholding of the sort proposed but we would be glad to submit any further information you would like to have.

The CHAIRMAN. Would you care to make up a study of whether or not the taxation that should be paid in dividends and in interest that accrue through the banks can avoid tax evasion by the numbering system?

Mr. WELMAN. May I ask Dr. Walker to answer that question?

The CHAIRMAN. I mean escape from taxation.

Mr. WELMAN. If I may, sir, I would like to ask Dr. Walker to answer that question.

Mr. WALKER. Yes, sir; we shall be glad to do so, Senator, and we will attempt to include it in our supplemental statement that you have permitted to be submitted.

The CHAIRMAN. Make it inclusive and leave all this talk about propaganda out; I want to know actually whether it can be incorporated by the Internal Revenue on the numbering basis, and thereby prevent any recipient of interest of the banks or dividends from evading taxes; is that clear?

Mr. WALKER. Yes, sir.

Senator KERR. Would the Senator yield?

The CHAIRMAN. Yes.

Senator KERR. I apologize for not having been here sooner.

Would it be all right with the chairman if he went ahead and put the propaganda in and put it in in an appendix? [Laughter.]

After all, Mr. Chairman, it seems to be a rather harsh rule to entirely exclude it, but if it is added as an appendix and properly identified, would that be acceptable?

The CHAIRMAN. It would be entirely acceptable, but give the other information first. [Laughter.]

Put the propaganda at the bottom.

I have no further questions.

You have a very clear statement, sir.

Senator?

Senator KERR. No questions.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. I have no questions at this time.

The CHAIRMAN. Senator Anderson?

Senator ANDERSON. The newspaper carries a story of the fact that United States Steel is going to increase the price of steel. I judge from your statement you approve all parts of this bill except the two things to which you take exception. You say the bill reflects a great amount of dedicated effort.

You are generally in approval of it then?

Mr. WELMAN. Senator, we have no official position on the other sections of the bill except these two that we have testified about.

Senator ANDERSON. Wouldn't it be helpful if you did have a position on them?

Mr. WELMAN. Well, sir, possibly.

Senator ANDERSON. Here is United States Steel saying they are going to raise the price of steel.

The investment credit would give them maybe a hundred million dollars the first year on plans they have already drawn up and had approved by the board of directors last year.

Why give them a hundred million dollars for incentive to do what they have already planned to do.

Doesn't the American Bankers Association have a feeling on that?

Mr. WELMAN. May I ask Dr. Walker to give you any information he has? I don't believe we have any position on the other sections.

Senator ANDERSON. Don't you have any feeling, I said? I didn't say position. [Laughter.]

Senator KERR. Or a little propaganda? [Laughter.]

Senator ANDERSON. Thank you, Senator Kerr. [Laughter.]

Mr. WELMAN. I am sure various bankers have various feelings on it.

Senator ANDERSON. The bankers have been writing me with great regularity and they have feelings on a great many things.

Why don't they have some feelings on this?

Mr. WALKER. If I might supplement Mr. Welman's comment. Other parts of the bill have ben discussed at least informally by various committees of the association. But as he stated, no formal position has been taken on sections of this bill other than section 8 and section 19. I think one reason for this is that the association in the past has concentrated its policy positions upon items of very direct interest to banking such as section 8 and such as section 19.

However, the association is in the process of broadening its policy positions, and we were pleased to present a position on the trade bill last week to the House Ways and Means Committee but we have not been able to work out positions on the other parts of the tax bill.

We hope in the future to be able to broaden out in that respect.

Senator ANDERSON. Certainly the use of investment credit is as much down in the line of banking as a trade policy, isn't it?

Mr. WALKER. It is a matter of which one we got to first, Senator. Investment credit is important and it was discussed.

I would report that there is a considerable divided view on this portion of the bill among bankers throughout the country.

Senator ANDERSON. The New York Times of April 3 carried a news story:

> Bell System sets new high. Its profit was $1,843,879,000 a year.

Now, this investment credit would give them, as a regulated utility, only getting 8 percent, only about $104 million. Their profits were up a hundred million dollars above last year.

Does the Bankers Association believe that is a good or a bad thing?

Mr. WALKER. I think the association would be reluctant to comment on the profits of a particular industry. I think the association——

Senator ANDERSON. The telephone company has a deposit in every town, hasn't it? [Laughter.]

Mr. WALKER. I would think we would be reluctant to comment even on those that don't have deposits.

Senator ANDERSON. Let me get down to whether or not they have; they may have. The bill as it passed the House gives a man who acquires a breeding bull investment credit for his assistance to productivity. If he pays $50,000 for a breeding bull, and if his profits are sufficient, he can take off $3,500 of that cost because he has contributed to productivity.

Have you got any feeling on that? [Laughter.]

Mr. WALKER. No, sir; I have no feeling on it.

Senator ANDERSON. I have. I think it is a bad provision. [Laughter.]

I was very much touched when they were telling how much taxes the Bank of Missouri paid. Some of us subscribe to devices that tell

us what we ought to do to watch our taxpayments, and I spend money for one or two of these services. In one that I got, dated April 9, it says:

Dollar savings tax credit on the way. Big new investment credit passes House. It can touch your tax bill by thousands of dollars.

Now, along with trying to get out of paying taxes, don't you think we ought to try to avoid these things that reduce these amounts by so much money? Doesn't the Bankers Association watch that?

Mr. WELMAN. Certainly the Bankers Association favors everybody paying a fair share of the taxes. I don't feel I am personally capable of having a very profound opinion on this investment credit because I simply don't understand it.

Senator ANDERSON. Well, I probably shouldn't have gotten into it, but I just remember that bankers write me regularly about how things get out of hand back here. I do not have any stock in a building and loan association or mutual savings bank. I do have a little bank stock that I hang on to, and they write me fully and I just hoped that the American Bankers Association might come in and say that a tax bill designed to plug loopholes which loses revenue is a bad bill.

Mr. WELMAN. Well, sir, I want to agree with Dr. Walker's comment that the association should take a more active position on a great many more things than they have, and I am very pleased to see him moving in that direction in his official position with the association.

Senator ANDERSON. Well, I appreciate it, too. I think that is fine, because there is a furniture amendment in this bill, investment credit for buying furniture for a new motel or hotel.

I see new signs up every day where new motels are being created. The old motels change because they are having a hard time getting along with the new ones. Yet they are setting up new competitors in this investment credit by telling them to build a new motel.

Don't the investment bankers think that is bad?

Mr. WELMAN. I didn't know that was in the bill.

Senator ANDERSON. That is one of the real fine things in the bill representing this dedicated effort that you are talking about. I have no other questions.

Senator KERR. May I make an observation, Mr. Chairman?

The CHAIRMAN. Senator Kerr.

Senator KERR. I would say to the representatives of the American Bankers Association that I find myself in disagreement with the distinguished Senator from New Mexico more often than not, but I can understand how the American Bankers Association might feel that they could tend to their own business better if they didn't try to tend to everybody else's also.

Mr. WELMAN. Yes, sir; that is correct, sir.

I think there is a very fine line between what does and does not very strongly involve the public interest.

The CHAIRMAN. If I might be permitted to make the statement there, I think the American Bankers Association is very much interested in any provision of the tax bill that will lose $1,400 million annually in revenue, that is what this 8-percent credit will do.

Senator KERR. I will tell the chairman how we can recover that, is to compel the bankers to pay 5 percent interest on savings and not let municipals be eligible for purchase by banks. [Laughter.]

We could recoup more than that amount of money just like that.

Couldn't we, Mr. Witness?

Mr. WELMAN. I am sure we could, sir.

Senator ANDERSON. Mr. Chairman, if we are going to get into this question, I only want to point out I want you to comment on lobbying.

You think this lobbying is a good thing and ought to be permitted, particularly this communicating with respect to legislative matters? We have a taxpayers association in my State of New Mexico. When I was a newspaper reporter 40-some years ago up at the State capital, I think the taxpayers association was solely supported by the Santa Fe Railroad and the Southern Pacific Railroad.

Now, they broadened the base, they take in all the banks and a lot of other individuals in it. They are conducting a steady campaign of lobbying on bills that are now pending in the Congress.

If you think that it is a good thing that they stay in their own field, perhaps they should.

Why did you get into the lobbying field; why do you think that is so good?

Mr. WELMAN. We, of course, are not affected by this bill because we have been checked regularly and only a minor portion of our expenses are for lobbying.

Senator ANDERSON. That is exactly what Senator Kerr said, you should attend to your own business. Now you get off into somebody else's business. Why are you off in that?

Mr. WELMAN. We felt this represented the public interest by making it clear that expense for presentation of testimony and gathering of data and furnishing it to the Congress in an effort to clarify various items of legislation is a deductible item.

Senator ANDERSON. Did you ever check how many hotel suites in this town are regularly reserved by certain groups?

Mr. WELMAN. No, sir; I haven't.

Senator ANDERSON. Well, do you think they all have to have people here all the time entertaining Members of the Congress?

Mr. WELMAN. I wouldn't think so.

Senator ANDERSON. That is why I don't understand why you think this lobbying provision is such a good provision?

Mr. WELMAN. Our desire was that it be clarified and perhaps it is too broad in the sense we stated it. As I say we are not affected directly. We thought the problems would be clarified, and we think we should have proper regulations to keep it within bounds and it should be within bounds.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. I am glad to have your statement and I won't try to touch on everything that is in it but in reference to the withholding on dividends and interest, you oppose the withholding on both dividends and interest, do you not?

Mr. WELMAN. Yes, sir.

Senator CURTIS. Now, I wonder if your technical staff has made any computation in reference to a college endowment fund, its ownership of stock with a corpus of a million dollars, some of them may be a lot more and some a lot less, but an illustration of a million dollars.

If the withholding tax is applied to those dividends, and then it is refunded afterward because as I understand there is no provision for them to be exempt from withholding, at average rates of earnings on stock and average rates of earning on the money they are deprived of here, I would like to know how much loss would be suffered by a college endowment fund on the basis of a million dollars of stock for 1 year?

Mr. WELMAN. Senator Curtis, may I ask Dr. Walker to answer that since it involves study and some effort on the part of the association?

Mr. WALKER. We will be glad to prepare it.

Senator CURTIS. I want the mathematics on it if he will submit it at a later time.

Mr. WALKER. Yes, sir.

(The information referred to was later received for the record as follows:)

A common stock portfolio of $1 million at current prices yields about $30,000 per year. Of this amount, $6,000 (20 percent) would be withheld by the payers. If the portfolio were held by a tax-exempt organization, such as a college, exemption certificates would not be available. Assuming refunds were available by the end of the quarter in which the dividends were payable, the organization would be deprived of the use of $6,000 for one-fourth of the year, or an average of $1,500 during each quarter. It could have earned, at present stock yields, an additional $45 per year on this amount, if the income withheld had been intended for reinvestment. The organization would also have the additional expense of filing four times each year for refund of the amounts withheld.

Senator CURTIS. Now, in reference to savings and loan associations, do you make a distinction between the mutuals and the stocks?

Mr. WELMAN. No, sir; we have not, sir.

Senator CURTIS. Is it then your position that they should be treated exactly the same?

Mr. WELMAN. Yes, sir.

Senator CURTIS. Now, in reference to the figures you quoted upon the earnings of savings and loan associations, is that before the payment of dividends?

Mr. WELMAN. No, sir; that is after the payment of dividends.

Senator CURTIS. After the payment of dividends?

Mr. WELMAN. Yes, sir.

Senator CURTIS. And what is the tax status of the amounts of interest paid by banks, not the amount of interest but what is the tax status?

Mr. WELMAN. It is deductible, the same as savings and loan and the interest paid by mutual savings banks.

Senator CURTIS. For the purpose of taxation you feel that they should be so regarded, both of them alike?

Mr. WELMAN. Yes, sir; that is correct, sir.

Senator CURTIS. Yes. Now, in reference to a bad debt reserve, if the formula ultimately agreed upon would be based solely upon new loans made as it was suggested at one time, would that not be inflationary?

Mr. WELMAN. I don't believe it would, sir.

Senator CURTIS. What I mean, if you put an association in a position that the more loans they made in a given year the less their tax would be, we would be penalizing the conservative operation as against the other one, would it not?

Mr. WELMAN. On the other hand, sir, the more income there would be; the more it would generate income which would be taxed.

Senator CURTIS. My question does not quarrel with the imposition of the tax. I think the tax should be increased, but my question is in writing the formula it was suggested at one time that it be based upon the new loans. Wouldn't it follow that savings and loan associations would have an inducement to make more loans in order to lower their tax?

Mr. WELMAN. Perhaps. There might be a small element of that existing. However, I would still depend primarily on the management, the supervision, and the record of lending in the mutual industry.

Senator CURTIS. But net profit probably would be a better thing to gear the taxation to than how much was loaned; is that correct?

Mr. WELMAN. We believe, sir, that loss, bad debt reserves geared to actual experience, would be preferable to the percent of profits. A bad debt reserve should be more applicable to the risk taken on the amount of loans.

Senator CURTIS. You think the bad debt reserve for commercial banks, the country's banks, should be increased or do you think it is adequate?

Mr. WELMAN. There again we have quite a divided opinion among our members. I personally think that with the supervision and the earning power of the banks that it is adequate. A great many of my friends disagree with me.

Senator CURTIS. We do have a problem in agricultural areas where farming has become so expensive, agricultural loans to individual family-sized operations have become so large, they have to go outside of their community for banking credit; isn't that true?

Mr. WELMAN. In some areas, yes; that is correct. In some areas, country banks are obtaining the participation of city banks and getting their help in expanding agriculture.

In my own case we are doing that. We are making a great many larger loans than we used to make in this kind of thing and, of course, we contend that our loans made to farmers on cottonpickers and cornpickers and combines, tractors, and equipment, and sometimes mules and things of that sort, are just as risky, if not more so, than the mortgage loans made by a mutual institution. And we do think we are subjected to as much risk as the mutuals. I personally, feel the bad debt reserve we have and the ability to replace them when we have had losses is adequate. In addition, we still protect the banks with supervision.

Senator CURTIS. But your community is a community of 9,000?

Mr. WELMAN. Yes, sir; that is correct, sir.

Senator CURTIS. I do not know what the average size of the communities served by our country banks in Nebraska is but I am sure it is much, much less than that.

Mr. WELMAN. The average, yes, sir, would be less.

Senator CURTIS. Even our county seat banks serve a territory of a lesser population than 9,000.

I will not take more time but I would appjreciate that tabulation with reference to the college endowment funds.

Mr. WELMAN. Yes, sir.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. Mr. Welman, could you tell me the approximate total amount of loans by commercial banks on home mortgages?

Mr. WELMAN. May I ask Mr. McNeill or Dr. Walker if he has that information, please, sir?

Mr. WALKER. It is right at $20 billion for residential and $29 million for total mortgages, sir. I will get the exact figure for you.

Senator DOUGLAS. What would be the volume of loans on homes of the savings and loan associations and the mutual savings banks?

Mr. WALKER. I will get those figures in just a moment, Senator. At the end of 1961, savings and loan associations had almost $69 billion in total mortgage loans: FHA, VA, and conventional.

Senator DOUGLAS. And the mutual savings banks?

Mr. WALKER. For the savings banks as of the latest Federal Reserve bulletin at the end of September 1961, the figure was almost $26 billion in residential mortgages.

Senator DOUGLAS. The two together has $95 billion or approximately five times the volume of loans of the commercial banks.

Mr. WALKER. And the commercial bank figure is almost $21 billion rather than $20 billion I stated.

Senator DOUGLAS. It is still almost five times. So that the savings and loan associations and mutual savings banks are bearing some 80 percent of the burden or business of providing for individual homeownership; isn't that true?

Mr. WALKER. Of those three types of institutions. There are also a number of other lenders in the home mortgage field, particularly insurance companies and individuals.

Senator DOUGLAS. Now, what is the total investment of the banks of the country excluding mutual savings banks in State and municipal bonds?

Mr. WALKER. I would say close to $20 billion but I would like to check that figure.

Senator DOUGLAS. I think that is approximately accurate. I will accept that figure: Now, when a bank sells as State or municipal bond at a loss, how is this loss treated for tax purposes?

Mr. WALKER. Is this a non-Federal Government bond?

Senator DOUGLAS. Yes; that is right.

Mr. WALKER. I would have to ask Mr. McNeill.

Senator DOUGLAS. If you sell a State and municipal bond at a loss, how is this handled for tax purposes?

Mr. WALKER. Ordinary loss deductions.

Senator DOUGLAS. And, therefore, you save 52 percent of the loss: is that correct?

Mr. WALKER. If you are in that tax bracket, yes; we have a number of banks——

Senator DOUGLAS. I mean as a corporation you would pay 52 percent: isn't that true, except if you were a very small bank?

Mr. WALKER. That is correct.

Senator DOUGLAS. Or take an average figure, say, 51 percent?

Mr. WALKER. Forty-nine.

Senator DOUGLAS. So if you have a loss, this reduces the ordinary amount of corporate tax which you otherwise would pay and you effect a saving of 51, 52 percent of the loss?

Now, suppose you sell a Government bond at a gain, is this treated as income or as capital gains?

Mr. WALKER. Capital gains, sir.

Senator DOUGLAS. And in this event you pay only a maximum of 25 percent; isn't that true?

Mr. WALKER. That is correct, sir.

Senator KERR. To the Federal Government.

Now, then, do you think this is tax equality, getting 52 percent or 51 percent credit on a loss on Governments, or other losses but only paying 25 percent upon a gain?

Mr. WALKER. This is a provision, as I am sure the Senator is aware, that was introduced in the Internal Revenue Code in 1942 under the support of the Treasury, Mr. Randolph Paul, in particular, supported this provision, to add to the breadth and the performance particularly of the Government securities market. It was in recognition of the fact that commercial banks rather than being long-term investors in these types of instruments, more often are lending institutions and these are held as secondary reserves.

With respect to the tax uniformity aspect, we would point out that the institutions which we are discussing here today, the savings and loan and mutual savings banks have the same sort of tax treatment provided to them.

Senator DOUGLAS. I understand. But certainly the crisis of 1942 has been removed. At that time it was very important to get a market for Government bonds and it was quite clear that the political situation was such that we could not finance the war by taxation, and a large portion of it had to be financed by bonds. So the Government wanted to promote a market for the bonds such as Secretary Chase did during the Civil War when he created the banking system.

Now, that emergency is over.

If you believe in tax equality, should there not be equality in the treatment of losses as well as gains?

Mr. WALKER. I think, sir, in all due respect we might disagree on the definition of tax uniformity.

Senator DOUGLAS. Equality?

Mr. WALKER. Tax equality.

Senator DOUGLAS. Tax equality.

Mr. WALKER. But I would say that the Treasury Department with respect to this rather significant tax revision proposal now before the committee has not seen fit to ask for a change in this particular provision.

Senator DOUGLAS. I know.

You are sufficiently acquainted with the legislative process, aren't you, Dr. Walker, to know that Senators are not mere robots. They are privileged to have ideas of their own, and even though the Treasury has not suggested it, I am raising the question as to whether it would not be a very good thing in the interest of tax equality to

have equal treatment given to losses on Government bonds as well as to gains.

Mr. WALKER. Well, our view of tax equality is for competing institutions to have equal treatment under the tax laws and they do on this provision.

Senator DOUGLAS. Well, of course, there is a question as to the proportion of the savings and loan funds which are invested in State and municipal bonds as compared to the proportion of banking funds.

Now, you say the commercial banks have approximately $20 billion in State and municipal bonds.

What percentage of total bank loans and investments are in this category?

Mr. WALKER. Of total bank loans and investments?

Senator DOUGLAS. Yes; I think that is right.

Mr. WALKER. I would have to check that. It looks to be approximately 10 percent, but I would like to check it for the record. (The witness later supplied the figure as 9 percent as of June 30, 1961.)

Senator DOUGLAS. What about Federal bonds?

Mr. WALKER. Federal bonds amount to $82 billion out of a total loans and securities of $200 billion or about close to 30 percent

Senator DOUGLAS. Now, do you have the same tax treatment in the case of Federal bonds?

Mr. WALKER. That is correct, and that was the major reason for that amendment to the code in 1942, as we noted.

Senator DOUGLAS. So that the combination of the Federal bonds and the State bonds form $78 billion out of $200 billion or approximately 40 percent?

Mr. WALKER. Yes, sir.

Senator DOUGLAS. And on these you get a credit of 52 percent on losses and only pay 25 percent on gains?

Mr. WALKER. That is correct.

Senator DOUGLAS. Isn't this quite a tax privilege which is given to the banking system?

Mr. WALKER. I would say it is a difference in tax treatment and it certainly contributes to the stability of the performance of the Government securities market which I think is highly important.

Senator DOUGLAS. Do you know what proportion of the funds of the building and loan associations are invested in national bonds and State and local bonds?

Mr. WALKER. Well, I can answer the State and local bonds rather quickly. They would hold a very negligible proportion of those because of their tax position, they would not be interested in tax-exempt income.

Senator DOUGLAS. And what about the Federal bonds?

Mr. WALKER. The Federal bonds, I think were approximately 7 or 8 percent of their assets.

That I would like to check.

(The following was later received for the record:)

On December 31, 1961, savings and loan associations had total assets of $82,061 million, of which $5,181 million, or 6.8 percent, consisted of U.S. Government obligations.

Senator DOUGLAS. So that this favorable treatment on taxation of bonds affects 40 percent of the loans of private banks but only 7 or 8 percent of the loans of the building and loan associations?

Mr. WALKER. Well, we would look at their portfolio distribution as a matter of choice on their part, and I would think that in part or significantly, it has been influenced by their overall favorable tax treatment with respect to all of their operations.

Senator DOUGLAS. I am for the general principle of tax equality moderated by the principle of mutuality. But since the question of tax equality has been raised, here is a treatment which certainly favors the private banks of the country as compared to the building and loan associations and the mutual savings banks so that the difference in taxation of profits is not all one way, that is the point I am trying to make.

Mr. WALKER. We would have no objection to their building up their portfolios of Government and/or State and local securities.

Senator DOUGLAS. Would you have any objection to changing the tax provision so that the gains on the sale of Government bonds would be taxed as income?

Mr. WALKER. Yes, sir; we would.

Senator DOUGLAS. Since it is credited as a loss, would you have any objection to having the gains taxed as income?

Mr. WALKER. Yes, sir; we would.

Senator DOUGLAS. Well, now, wouldn't—isn't this objection a violation of the principle of tax equality?

Mr. WALKER. Not as I am speaking of tax equality here today, Senator.

I do believe that it is fair among competing financial institutions.

Senator DOUGLAS. Suppose the savings and loan associations were to come in and say they would be willing to have the gains treated as ordinary income; would you object then?

Mr. WALKER. It is their right to say what they like in that respect. I would not agree with them, that it is proper for that to be done; no.

Senator DOUGLAS. May I ask this question:

You are an experienced student of monetary matters, both academic and practical—can banks create credit?

Mr. WALKER. They can create money; yes, sir.

Senator DOUGLAS. They can create money. I am glad that is established. [Laughter.]

Admitted. What is the reserve that you have to have against this money in terms of Government bonds; what proportion?

Mr. WALKER. Well, there is no reserve requirement for Federal Reserve member banks in terms of Government bonds. There is a cash reserve requirement of——

Senator DOUGLAS. We have a fractional reserve system.

Mr. WALKER. Correct.

Senator DOUGLAS. What is that fraction; approximately about one-sixth?

Mr. WALKER. About 15 percent. It varies for location of banks.

Senator DOUGLAS. So that on the purchase of $15 of Government bonds you can create a hundred dollars of credit or money; is that right?

Mr. WALKER. No, sir.

Senator DOUGLAS. I mean the system as a whole?

Mr. WALKER. No, sir; it doesn't relate to your purchase of Government bonds. It means for every dollar of extra cash or reserves a member bank has or can get hold of, it can expand its own loans and investments——

Senator DOUGLAS. How do you get that reserve?

Mr. WALKER. You get that reserve from certain basic sources, such as an increase in your gold stock, a decline in currency in circulation or an increase in Federal reserve purchases of securities from the banking system, or loans to the banking system.

Senator DOUGLAS. That is not credited to your accounts?

Mr. WALKER. It is credited to the bank's account. If Mr. Welman's bank, or let's say some other bank, were to borrow directly from a Federal Reserve bank, yes, that would be credited to the account of that particular bank.

Senator DOUGLAS. Precisely so.

Mr. WALKER. But Government securities are not necessarily involved in that transaction?

Senator DOUGLAS. No; but I mean that is credited to your account; isn't that true?

Mr. WALKER. Yes, sir.

Senator DOUGLAS. And if you have a credit of $15 or $15 million, that permits you to create a hundred dollars or a hundred million dollars of credit, isn't that true?

Mr. WALKER. Yes, sir; the banking system can create it.

Senator DOUGLAS. The banking system.

This is quite a privilege. You are acquainted with the clause in the Constitution which says Congress shall have the power to coin money and regulate the value thereof. That is in the Constitution, isn't it?

Mr. WALKER. That is correct, sir.

Senator DOUGLAS. This is a privilege which we delegate to the private banking system with the rationing of the total amount in the hands of the Federal Reserve System; isn't this true?

Mr. WALKER. Yes, sir.

Senator DOUGLAS. That is the major portion of the business which the private banks in the country do; isn't that true?

Mr. WALKER. Well, sir, I am not sure how to interpret——

Senator DOUGLAS. The major portion of the commercial bank system.

Mr. WALKER. This is part of the bank's operation.

Senator DOUGLAS. And a large part of the deposits in the savings banks are derivative from the accounts of the commercial banks; isn't that true?

Mr. WALKER. Derivative from money-creation activity; yes.

Senator DOUGLAS. That is right.

Do the savings and loans associations have this privilege?

Mr. WALKER. Not to create anything that circulates as money. They can create obligations which are close to money.

Senator DOUGLAS. I understand.

But it is very different from a checking account and I want to congratulate you, Dr. Walker, for the frankness with which you have identified the creation of commercial credit and "money."

Now, I think it is very important that this fact is established and I want to congratulate you on the honesty and frankness with which you answered the question and now I want to ask, Is there any comparable privilege which is given to the savings and loan associations?

Mr. WALKER. The privilege of creating money?

Senator DOUGLAS. Credit.

Mr. WALKER. I like the term "money."

Senator DOUGLAS. All right. You identified credit as money.

Mr. WALKER. I think of credit in terms of an individual's ability to borrow.

No, sir; they don't have that comparable privilege because they are not subjected to the comparable responsibility and requirements of banks.

Senator DOUGLAS. I understand.

In other words, the mutual savings system and the building and loan associations are in the nature of savings banks where the deposit comes first and the loan is made later.

Whereas in the commercial banking system the loan comes first, and the deposit comes later, or the two take place simultaneously, isn't that true? But it is the loan that creates the deposit.

Mr. WALKER. Throughout the banking system with respect to the demand deposit operation; but we are more concerned with respect to tax uniformity of that portion of the commercial banking business which is directly comparable with the mutual institutions, namely, the more than $80 billion of time and savings accounts. Commercial banks are department stores of finance and the demand deposit operation, while it is the majority of our operation, this other $80 billion is highly important.

Senator DOUGLAS. I understand; I understand.

But so far as the commercial banking is concerned, Congress has given you the power of creating money, and, with the Federal Reserve System getting a commission of 15 cents on the dollar; isn't that true?

Mr. WALKER. I would question the commission aspect. The Federal Reserve actually creates and controls those reserves which provide the basis for monetary creation.

Senator DOUGLAS. It creates the credit which you use to draw interest upon; isn't that true?

Mr. WALKER. Which we use in the process of the lending function.

Senator DOUGLAS. Which you lend and draw interest upon; isn't that true?

Mr. WALKER. We draw interest upon our assets, our earning assets which result in part from that.

Senator DOUGLAS. Yes.

Those are based at 6⅔ times of the amount of Government bonds credited to your account in the Federal Reserve banks; isn't that true?

Mr. WALKER. The total demand deposits; yes. But what I would point out in that respect, Senator, is that the demand deposit function is often viewed, particularly for classroom purposes, in the way you and I are discussing it this morning. But in the actual day-to-day workaday operations of the commercial banking system it is a highly competitive atmosphere with respect to the extent of which banks will be able to attract and hold these funds.

Senator DOUGLAS. I understand that. But the banking system as a whole is given this great privilege?

Mr. WALKER. But most of the activity has to do not with the rising amount of demand deposits but with the allocations of deposits among the existing institutions. That is the main function commercial banks serve in the money system.

On that side of it.

Senator DOUGLAS. I am not proposing to abolish the commercial banking system, let me make that clear; but I do think that in deciding, in passing judgment, on the relative taxation of savings and loan institutions, on the one hand, and the private banking system, on the other, that these two differences should be kept very clearly in mind. We should not concentrate our attention entirely upon this 52 percent for the banks on the one hand, and the reserves which are tax exempt on the other which are set up for the savings and loan institutions, wouldn't you say that?

Mr. WALKER. No, sir; we would disagree with that. Our demand deposit function, Senator, if I might point it out, is the most expensive operation of a commercial bank. Commercial banks as a group are involved with administering the demand deposit accounts, the clerks, the amount of bookwork and paperwork.

Senator DOUGLAS. Wait a minute, I am not suggesting that you don't have expenses in allocating who is to get the total amount that is created. I understand that and I am not saying that your gross profit is a net profit by any means.

I simply say that Congress and the Government has conferred a great favor upon you. Of course, if you don't want to be in the banking business you can resign and give it up but I always thought a bank was quite attractive to a considerable number of people and, therefore, Congress has done very well by you.

Mr. WALKER. Well, sir, I think the bankers would say that if you compared their rate of profits on capital with practically all other business they come out toward the low end of the spectrum.

Senator DOUGLAS. I see. I would be very interested in knowing that.

Mr. WALKER. I would, too.

Senator DOUGLAS. That is all.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman.

Earlier this morning, the Senator from New Mexico raised a very interesting problem that I would like to pursue a minute or two. He raises the question as to whether or not savings and loan associations couldn't escape the tax if it were increased by simply paying more to their depositors, and I would like to get some specific information in the record in order that the committee may understand whether this is a real prospect or not.

Can you put back into the record, if they are not contained in your testimony or these various exhibits, the approximate relationship between the volume of time deposits that go into the savings and loan and mutual savings areas as compared with the time deposits that go into the commercial banks.

Mr. WELMAN. May I see if Dr. Walker can answer that?

Mr. WALKER. The total figures at the end of 1961 were: for the mutual institutions, $109 billion of total savings accounts and deposits,

and if you would like the breakdown, about $71 billion in savings and loan associations, and $38 billion in mutual savings banks.

For commercial banks the figure for savings and time deposits of individuals, partnerships, and corporations at the end of 1961 was approximately $76 billion which includes, unfortunately, some nonsavings accounts; that is, some deposits of business corporations and so on.

Senator BENNETT. Do you have any idea what proportion of the $76 billion would be represented by those nonthrift accounts?

Mr. WALKER. Our latest figures indicate that roughly $10 billion or so; we will get a more exact figure for the record.

(The witness later supplied the figure as $11 billion of nonindividual savings held in total savings and time deposits of individuals, partnerships, and corporations as of June 30, 1961.)

Senator BENNETT. So roughly $65 or $66 billion are going into the commercial savings. So their volume of business is not double yours but it is considerably higher.

For the record, have you any estimate as to the average or the current or the traditionally higher rates the savings and loan associations have paid compared with those that the banks have paid? How much more have they been able to pay than you?

Mr. WALKER. Yes, sir; we have figures on that. Here we get into statistical difficulty with respect to what they offer and what is the effective rate paid.

Senator BENNETT. Yes.

Mr. WALKER. The average effective return to savers for savings and loan associations—the latest figures we have are for 1960—was 3.86 percent, and the rate for commercial banks was 2.56 percent in 1960.

Both of those figures have gone up considerably since then and we will be glad to get the latest and submit it for the record.

Senator BENNETT. But on the basis of that they have been able to offer a rate approximately 50-percent higher than yours and have attracted something less than double the amount of the savers' money?

Mr. WALKER. And growing at a very rapid rate over the past 10 years; yes, sir.

Senator BENNETT. Has the relationship of rate been such that they have been growing at a much more rapid rate than you have?

Mr. WALKER. Yes, sir.

Senator BENNETT. So that we could expect before too long that their deposits would be double yours, and this is a prospect?

Mr. WALKER. Yes, sir.

Senator BENNETT. So they have been able to compete effectively?

Mr. WALKER. Yes, sir.

Senator BENNETT. The next question is going to be a little more difficult to answer: According to your testimony, they had, the 4,700 savings and loan associations had, net income after the payment of dividends of $564 million. Suppose we were to follow the idea of the Senator from New Mexico and assume that in order to protect themselves if the bill only required them or only permitted them to set up a 3-percent reserve tax free instead of 12 percent, so they would now then have that additional amount, how much could they increase their payment to savers out of that difference? I assume

the whole difference—no; they would have to take some of this $564 million and put it into reserves. Under the present situation, they are free to do what they please as long as it doesn't exceed 12 percent.

Can you do a calculation for us and give us an impression of how much they could increase this effective rate and still not be subject to taxation?

Mr. WALKER. And still not be subject to taxation?

Senator BENNETT. Yes. As I understood the approach of my friend from New Mexico it was that they could pay this out as dividends or as——

Senator ANDERSON. Dividends.

Senator BENNETT. Yes; as dividends. They are now paying 50 percent more as dividends than you can pay as interest.

This was the effective situation in 1960. Now, by how much could they increase that rate if they decided to go this route and avoid taxation by paying more out in dividends?

Mr. WALKER. Well, you ask how much. First of all, you can ask how much of net income they could pay out and avoid paying any taxes. They would have to pay out all.

Senator BENNETT. They would have to pay out all of the $560 million?

Mr. WALKER. Except that which went under the 3 percent provision.

Senator BENNETT. That is the point I wanted to get at. Assuming they decided to go that route by how much would they raise this rate, on the average, they are paying the depositors?

Mr. WALKER. We can figure that quickly if we can get earnings before dividends and see how much this would increase their dividend payout.

Senator BENNETT. I am trying to estimate the magnitude of this prospect.

Mr. WALKER. Member savings and loan associations had about $2.7 billion of earnings before dividends and paid out about $2.2 billion in dividends.

If you paid out an extra $500 million you would increase the rate by about 25 percent. That is horseback figuring.

Senator BENNETT. Yes. So roughly calling this 3.86, a 4-percent rate for easy figuring, they could go up to 5 percent, increase the rate 25 percent and on the average pay out 5 percent before they began to run into difficulty.

Mr. WALKER. I would like to be able to check that, but it seems to be accurate.

(The following was later received for the record:)

In 1960 member savings and loan associations had net income of $2,743 million, of which $2,184 million was paid in dividends and $559 million was retained in reserve or surplus accounts. Average savings capital for the year was $56,614 million, so that the effective dividend rate was 3.86 percent. If all funds retained were paid out in dividends, the effective rate would have been 4.85 percent. If an amount equal to 3 percent of loan growth were retained ($208 million) and the remainder ($351 million) paid out in dividends, the effective rate would have been 4.48 percent.

Senator BENNETT. I am just trying to get an approximation of this business.

It would be interesting to try to speculate as to how many more savers they would attract on that basis since they already have a 50-

percent advantage over you now. There has been some substantial increase in the rates offered by savings and loan associations since the Federal Reserve permitted you to raise your rate to 4 percent.

Do you know of any that have reached 5 percent?

Mr. WALKER. I do not believe I know of any federally insured associations that have reached 5. I know of 4.75, and I think I heard of some 4.8s. There may be some 5s. There are a number of 5s in the nonfederally insured institutions.

Senator BENNETT. So some of these are now approaching this limit?

Mr. WALKER. Well, we would have to look at the particular institutions.

Senator BENNETT. Yes; I realize that. We are talking generalities, and these would not necessarily be borne out, and obviously the management of each institution is going to make its own decision on the basis of its own local situation and its own basic attitude toward its responsibility.

Do you want me to yield?

Senator ANDERSON. Just 1 second.

Could you supply us a list of those paying 4.8? The highest I know is 4.6. Where is it located?

Mr. WALKER. In California, I know a number have gone to 4.75 in the last weeks but I think there is a 4.8.

(The following was later received for the record:)

The New York Times of Sunday, April 8, 1962, carried in its financial section advertisements from the following savings and loan associations, with the indicated dividend rates:

	Percent
Rio Hondo Savings & Loan Association, South Gate, Calif	4.75
First Western Savings & Loan Association, Las Vegas, Nev	4.75
United Savings & Loan Association, Inglewood, Calif	4.75
Mutual Savings & Loan Association of Alhambra, Alhambra, Calif	4.75
Fidelity Federal Savings & Loan Association, Glendale, Calif	4.75
Atlantic Savings & Loan Association, Los Angeles, Calif	4.80
State Mutual Savings & Loan Association, Los Angeles, Calif	4.75
Mountain Savings & Loan Association, Boulder, Colo	4.75
World Savings & Loan Association, Los Angeles, Calif	4.75
San Diego Federal Savings & Loan Association, San Diego, Calif	4.80
Claremont Savings & Loan Association, Claremont, Calif	4.75
Southern Federal Savings & Loan Association, Los Angeles, Calif	4.75
World Savings & Loan Association, Denver, Colo	4.75
Peoples Federal Savings & Loan Association, Inglewood, Calif	4.75
Trans-World Savings & Loan Association, Ontario, Calif	4.75
Victory Savings & Loan Association, North Hollywood, Calif	4.75
American Savings & Loan Association, Whittier, Calif	4.75
Citrus Belt Savings & Loan Association, Riverside, Calif	4.75
San Gorgonio Savings & Loan Association, Banning, Calif	4.75
El Dorado Savings & Loan Association, Placerville, Calif	4.75
Pioneer Investors Savings & Loan Association, San Francisco, Calif	4.75
Home Mutual Savings & Loan Association, San Francisco, Calif	4.75
Berkeley Savings & Loan Association, Berkeley, Calif	4.75
Sacramento Savings & Loan Association, Sacramento, Calif	4.75
Nevada Savings & Loan Association, Las Vegas, Nev	4.75
Lytton Savings & Loan Association, Hollywood, Calif	4.80
Ventura Savings & Loan Association, Ventura, Calif	4.75
Broadway Federal Savings & Loan Association, Los Angeles, Calif	4.75
Sterling Savings & Loan Association, La Habra, Calif	4.75
Mutual Savings & Loan Association—Pasadena, Pasadena, Calif	4.75

Senator ANDERSON. Since this was in the last few weeks I wouldn't know it. Thank you.

Senator BENNETT. I have been happy to yield. It becomes an interesting question for management as to whether they are going to pay money to the stockholder or to pay more taxes, and mixed up in that is the question of how much additional business can they attract?

It would seem to me that, faced with the responsibility of prudent management, with an advantage already 50 percent, that they might create more problems for themselves than they would confer benefits on their depositors if the rates generally began to push upward toward 5 percent.

I would think this would have a tendency to push the mortgage rates up. Even though they had this margin theoretically, this might tend to push the mortgage rates up and might defeat the very purpose, because it is pretty hard to understand how an institution can pay 5 percent on deposits and loan the money for 6. Since the Federal Reserve raised the rate for commercial banks, and the savings and loan associations have responded and raised their rates, has this tended to put pressure upward on the rates for mortgages?

Mr. WALKER. Our most recent figures indicate the contrary. As many commercial banks have entered the home mortgage market in order to pay the higher rates there actually has been some softening of rates on conventional mortgages.

Fractionally these rates are in the first few days of March and there has been some softening down in the last couple of months.

Senator BENNETT. Has this been influenced by the fact that these increased rates on deposits have caused banks to turn very sharply toward tax-free bonds and thus reduced the amount of money that is available for mortgages?

Mr. WALKER. Well, no, sir; I would disagree with that. They have turned somewhat toward tax-free bonds and this is indicated by the favorable performance of the municipal bond market as yields have tended to decline and prices rise. But I know a number of banks that have turned strongly into the mortgage area. They are looking for mortgages all over the country. They are looking for new personnel to handle the mortgages they will be making. And at the same time the American Bankers Association is conducting studies and participating in studies to propose legislation which we think will improve the mortgage market so more banks and other lenders can enter into it.

Now, I think it is this aggressive entry into the market by commercial banks which has been a very significant factor in the easing off of the conventional mortgage rate.

Senator BENNETT. That is all I have, Mr. Chairman.

The CHAIRMAN. Senator Morton?

Senator MORTON. No questions.

The CHAIRMAN. Senator Hartke?

Senator HARTKE. In regard to that last statement, you say an aggressive entry; to what extent?

Mr. WALKER. Senator Hartke, we have no precise figures on the extent and we will not have until the banking data start becoming available in the weeks ahead. I could speak of individual banks that I know of that are aggressively seeking loans, and——

Senator HARTKE. I would like to have them.

Mr. WALKER. Yes, sir.

Senator HARTKE. I would like to have the names of those, yes.

Mr. WALKER. I could give you the names, yes. I know of particular banks being very aggressive.

Senator HARTKE. You could supply those.

Mr. WALKER. Yes, sir, I could and I would like also to point to a statement by the current president of the U.S. Savings and Loan League, who has stated recently that "competition from the commercial banks in the home mortgage field may be a more serious threat to associations than the new bank savings rates," meaning that the competition is going to be so severe that it is going to be hard to find good mortgages to put the savers' money in. That drives rates down.

(The following was later received for the record:)

The following list of banks was submitted for the record. Since it would be impractical to list all the commercial banks which, as of April 1, 1962, had evidenced an increasing interest in mortgage investment as a result of their ability to make higher interest payments, the banks listed below were selected on the basis of geographical location to reflect the wide national extent of this interest in mortgage lending. It should be emphasized that this is only a partial compilation, with banks chosen at random, and should not be considered representative of anything but a small fraction of banks in this category.

Union Trust Co., Washington, D.C.
First American National Bank, Nashville, Tenn.
Citizens and Southern National Bank, Atlanta, Ga.
Merchants National Bank & Trust Co., Indianapolis, Ind.
Manufacturers National Bank, Detroit, Mich.
First National Bank, Little Rock, Ark.
Northwestern National Bank, Minneapolis, Minn.
First National Bank & Trust Co., Oklahoma City, Okla.
Third National Bank, Nashville, Tenn.
Chase Manhattan Bank, New York, N.Y.
Commerce Trust Co., Kansas City, Mo.
Denver United States National Bank, Denver Colo.
State National Bank, El Paso, Tex.
Fort Worth National Bank, Fort Worth, Tex.
National Bank of Toledo, Toledo, Ohio
North Carolina National Bank, Charlotte, N.C.
Marine National Exchange Bank, Milwaukee, Wis.
City National Bank & Trust Co., Kansas City, Mo.
Peoples National Bank, Seattle, Wash.
Walker Bank & Trust Co., Salt Lake City, Utah
First National Bank of Chicago, Chicago, Ill.
First National City Bank of New York, New York, N.Y.

The list of banks aggressively entering the mortgage market is included in the appendix.

Senator HARTKE. I am not opposed to driving interest rates down. I want you to know that; it is all right with me. I would like to see that competition get a little tougher, I would like to see more homes built.

You said many have turned strongly into the mortgage area, and I just wondered upon what basis you make the statement?

Mr. WALKER. This is primarily on the basis of discussions with individual bankers and we can support this not only with reference to individual banks but we can also support that with articles from the press and journalists which are pointing this out.

I remember articles in the last couple of months in the New York Times, the Wall Street Journal, and various other papers about how banks are moving more aggressively into this field.

Senator HARTKE. Unfortunately, for the benefit of those people who are getting mortgages on their homes, statements by newspapers are not loans, are they?

Mr. WALKER. Yes, sir; but that is reflected in the rate they pay which is going down according to official Government figures.

Senator HARTKE. You have no estimate whatsoever of the extent to which the commercial banks since the first of the year have entered into the mortgage field?

Mr. WALKER. All I can say now is that it has been considerable and we will have figures as these banking data are compiled to indicate this; we will certainly supply them to you as they become available.

Senator HARTKE. What if I would say as an assumption it is about $200 million, would it be far from wrong—increase in the mortgages that have been done by commercial banks since the first of the year?

Mr. WALKER. I would not want to say, sir.

Senator HARTKE. Assuming that that statement is correct for the moment, and subject to your verification—I think you will find out it is pretty close to right—will you tell me what has been the extent of the increase in time and savings deposits by the commercial banks since the first of the year?

Mr. WALKER. Those have been very substantial, and I can get some recent figures for you. We don't have specific figures on that. We do know that both in commercial banks and in savings and loan associations, there has been a substantial increase in time and savings accounts, and I understand in January the increase in commercial banks is believed to be very substantial.

Senator HARTKE. You have no estimate as to that amount?

Mr. WALKER. As to that amount, no, sir, I do not, but I will certainly get it.

(The following was later received for the record:)

Data for all commercial banks showing savings and time deposits of individuals, partnerships, and corporations, real estate mortgages, and municipal obligations are not yet available for the first quarter of 1962. However, these data are available for weekly reporting Federal Reserve member banks.

Savings and time deposits of individuals, partnerships, and corporations in weekly reporting Federal Reserve member banks in leading cities increased from $36,033 million on December 27, 1961, to $39,248 million on March 28, 1962, or by $3,215 million. Of this increase only $1,557 million consisted of regular savings deposits, while $1,658 million consisted of "other time" deposits, much of which may not be suitable for mortgage investment.

Weekly reporting member bank investments in real estate mortgages increased from $18,399 million on December 27, 1961, to $18,620 million on March 28, 1962, or by $221 million. "Other securities" increased from $12,240 million to $13,294 million, or by $1,054 million.

As noted, these data do not cover all commercial banks. So far as real estate mortgages are concerned, the data above do not show total mortgage loans made by commercial banks during this period, but simply the net increase in portfolios. Nonfarm mortgage recordings of $20,000 or less in commercial banks exceeded $400 million in January alone, and were probably well in excess of $1 billion during the first 3 months of 1962. Further, real estate loan data do not include other loans made to finance the acquisition of mortgages, such as those to mortgage lending companies, nor do they include installment repair and modernization loans, or loans made directly to the home building industry, such as construction loans.

Senator HARTKE. If I would give a statement that it is approximately $3.5 to $3.6 billion, would you think that would be far from wrong, the increase?

Mr. Walker. I have heard figures in that range.

Senator Hartke. That has been a reported figure, is that right?

Mr. Walker. Yes.

Senator Hartke. Now, what has been the increase in the amount of investment by commercial banks in line with what Senator Douglas was talking about a few moments ago, in investment in tax exempt securities?

Mr. Walker. I am sorry, I don't have the figures.

Senator Hartke. If I would say, make the assumption that was in the neighborhood of about $1 billion, would you feel that would be fairly accurate?

Mr. Walker. I could not criticize it until the actual figures are released.

Senator Hartke. You could not. So what we have in substance here since the first 8 months of the year, then, is an increase in about $8.5 billion in increase in time and savings deposits by the banks; an increase in investment in tax exempt securities of about a billion dollars; an increase in commercial, by the commercial banks in the field of mortgages for homes of about $200 million, not billion but million; then I wonder how I can take this statement, there is no fact, no reason, to be concerned over housing.

If the prosperous mutual savings industry pays its fair share of taxes, I am frank with you, I can't see how it has any relation to housing.

Mr. Walker. Cannot see what? How this statement has any relation to housing?

Senator Hartke. Yes.

Mr. Walker. Well, we simply point out the development in the housing market, the statement by leaders in the housing industry, and statements from the lending industry that they are looking aggressively for loans, that the housing market is not suffering because of the lack of availability of credit. Quite the contrary, because of a decline in family formations and other factors, the actual demand for housing has slackened up.

Senator Hartke. Then in this statement here, you don't mean exactly what you say, at least what I understood you to say; that is, that there is, in fact, no reason to be concerned about housing.

Mr. Walker. We don't mean that at all. We mean that if this tax which we recommend, fair tax treatment of competing institutions is passed, that there is no reason to be concerned that the housing market will suffer as a result.

Senator Hartke. But there is an estimate by Senator Sparkman, I believe, that we are going to need about how many houses—are you familiar with these estimates every year, say, for the next 10 years.

Mr. Walker. I don't remember his specifically, I do remember some that were worked up by the Housing and Home Finance Agency and submitted to his committee, I think, last year.

Senator Hartke. That is right, and it was estimated we would need about a million and a half to 2 million homes every year, is that correct?

Mr. Walker. It was a little under that. It wasn't a million and a half to two, it was an average of a little more than a million and a half.

Senator HARTKE. Let's assume a million and a half.

Where is the money going to come from for the million and a half homes?

Mr. WALKER. The Housing and Home Agency as part of that particular study also analyzed the sources of mortgage funds and concluded that over that decade as a whole there would be a substantial surplus of mortgage funds for that period.

There would be $112 billion needed to finance the homes that they saw as necessary over that period but there would be $134 billion available for that purpose.

Senator HARTKE. Yes, but you have increased here in the commercial banks in this field alone by the fact these time and savings deposits over $3½ billion, and instead of going into housing it is going into tax-exempt securities.

I don't think that is going to produce many homes.

Mr. WALKER. Well, I would make two points in that respect, sir. First of all, when you have an overall increase in savings deposit rates at commercial banks as you did in 1962, and as you did in early 1957, you often get a quick shift of funds in the same bank from demand deposits to savings accounts.

These are not necessarily true long-term funds for investment in residential mortgages.

In the second place, we would point out very strongly, that it takes a great deal more than a residential mortgage to make a house a home in the strict sense of the term. Commercial bank and other institutions purchases of municipal securities is highly important because a very large portion of these securities are used to finance schools, sewage systems, roads and the other components that go into the making of homes.

Finally, we would point out that to stock a home with the goods that are needed for comfortable living, commercial bank consumer credit is very important. So we would take issue with the argument that simply because in a given period of time our time and savings deposits went up so much but mortgages didn't that the homebuilding or homeownership industry was being slighted.

Senator HARTKE. I am not being critical. I am merely trying to find out how you come to the conclusion on the housing and taxation statement, section 6, in saying this offer looks to the fact that the recent change of interest rate ceilings for commercial banks will substantially increase the flow of funds to the mortgage market and I didn's see how an increase of $200 million out of an increase of, say, time and savings deposits of $3½ billion roughly is substantially increasing the flow of funds to the mortgage market.

Mr. WALKER. Well, sir, if I might put it this way: The figures I have seen for the first couple of months of the year indicate that our competitors have suffered no loss of inflow of savings.

Now, that amount of money is still available for mortgages. Evidently this increase in commercial banks was a net increase, and if you add that to what the others are doing, you have a net increase in total mortgage loans.

Senator HARTKE. But you are talking about something else now. That is not what you said in the statement. You didn't say anything here about what they were doing in this business. You said here this would substantially increase the flow of funds to the mortgage market.

I don't think that anyone is going to contend that $200 million is a substantial portion of $8½ billion.

Mr. WALKER. But it is a substantial increase in the flow of funds to the mortgage market.

Senator HARTKE. $200 million.

Mr. WALKER. $200 million net total in 1 month is substantial.

Senator HARTKE. Three months.

Mr. WALKER. That is substantial, too.

Senator HARTKE. Out of $8½ billion increase in time and savings deposits?

Mr. WALKER. Let me say first of all, the one figure that I would have to look at closely is the $200 million. These figures on bank mortgage loans and residential loans are usually only available on the call dates and we won't have those figures for the first quarter of this year until the end of this year.

Senator HARTKE. In your supplemental statement you say:

> Many commercial banks, faced with higher costs because of increased savings rates, are being compelled to move more aggressively into the residential mortgage area in order to obtain the needed higher yields.

Don't you think a more informative statement would be that they have been compelled by virtue of this to move into the tax-exempt field?

Mr. WALKER. No, sir; all I can say on that is when the actual figures are finally available, I think you will see a combination of an increase both in bank holdings of municipals and in bank residential mortgages. I am convinced of that.

Senator HARTKE. Well, the investments so far have been about one-fifth of the investment into mortgages and four-fifths into tax-exempt securities, isn't that true?

Mr. WALKER. Sir, I would have to look at the mortgage figures, I would like to know the source of your figures because so far as I know we have not been able to obtain figures on the first quarter.

Senator HARTKE. What I am really driving at is this increase in the interest rate for time and saving deposits for commercial banks have not, in fact, resulted in an increase in mortgages, isn't that true?

Mr. WALKER. No, sir; I think it has. You say it hasn't resulted in a large increase, as large as you would expect.

Senator HARTKE. Substantial.

Mr. WALKER. I say it has resulted in a substantial increase.

Senator HARTKE. All right.

I think that is fair, as long as we just understand we differ on what is substantial. I just think $200 million out of $8½ billion is not substantial compared to $1 billion out of $8½ billion.

I think we can agree upon that, that $200 million is at least one-fifth the size of $1 billion.

Mr. WALKER. I would agree on that and I would also emphasize that I think we are performing a service not only to the economy, but to homeownership in buying municipal securities.

Senator HARTKE. I am not in any way, I hope, inferring that you don't perform services to the country. Let me ask you one other question.

Suppose this tax bill is passed either in the form in which it is now or in the form of the tax the Treasury or you suggest on a 66⅔-percent

basis, do you think this will have any effect upon the establishment of any new savings and loan institutions?

Mr. WALKER. I would think that on a judgment basis, to the extent that you have a tax provision such as they now enjoy, that there would be the continued rapid establishment of those when the chartering authorities permit.

It has been a rapidly growing and profitable industry, and it is obvious that it will tend to be more profitable the more the tax escape involved.

Senator HARTKE. One final question on a different matter.

In view of all of the attempts we have had in the field of governmental support of housing, of FHA, and so forth, a substantial portion is yet done by conventional mortgage loans without support of the Government.

Do you know what that percentage is?

Mr. WALKER. I think I could get it for you in just a moment. I would say over 50 percent, but I would just be guessing at it. I would have to check it. A very substantial proportion; yes.

You see the savings and loan are primarily conventional lenders, for example. They lend relatively very little now in FHA and GI.

Senator HARTKE. It might be as high as 66⅔?

Mr. WALKER. Well, I would expect it probably would.

Senator HARTKE. Fine.

How do you account for this fact?

Mr. WALKER. How do you account for the fact?

Well, without stepping on any particular toes, I think that the, first of all, there is not so much, shall I say, complication involved from the standpoint of meeting the Government's requirements, redtape, to go through the conventional route as perhaps the FHA route.

Secondly, you have a question of competitive interest rate levels when you have controlled rates, regulated rates, under the GI and FHA.

Thirdly, in this prosperous economy we have had since the depression of the 1930's, a good conventional mortgage properly amortized. It is a very safe investment for a lending institution.

As a consequence the guarantee and insurance of the FHA and the GI is not nearly so attractive as it would be. The total figures you are asking for on one- to four-family property at the end of last September was $150 billion in mortgage loans of which $59 billion was Government underwritten, FHA or GI, and $92 billion was conventional; 92 out of 150 is the proportion.

Senator HARTKE. All right; thank you.

Would you agree with the statement of our distinguished chairman that it appears that the interest rates are going to be pegged for a long time in the future at a very high rate?

Mr. WALKER. On what, sir?

Senator HARTKE. Overall interest rates in the United States.

Mr. WALKER. I disagree that they are pegged.

Senator HARTKE. Would you agree then that the interest rates themselves, which are going to—I do not know what word you want to use, I do not want to get into a question of semantics with you as you did with Senator Douglas on money and credit——

Mr. WALKER. Well, I would say if we have a prosperous, rapidly growing economy, which we hope to have, and which this tax bill is aimed at in many respects, that there will, in the future, be a strong demand for savings, and the interest rate is simply the reaction of the supply and demand for savings.

So if we have a prosperous economy, I think we will tend to have somewhat higher rates than we had in the 1930's, when we had a depressed economy. Low interest rates express a depressed condition.

Senator HARTKE. Our distinguished chairman—I do not want to get off this too far—but he said the increase in the governmental bond rate, extending it over a considerable period of time by the present action of repurchase of those which are not presently due, extending them to a greater time, is, in fact, an underwriting of a long-term increase in interest rates.

Would you agree with that statement?

Mr. WALKER. As much as I respect the chairman—and the chairman remembers, I think, that I was part of the official family that devised this sort of operation in 1959—it is my judgment that advance refunding, judiciously used under the provisions provided by the Congress and this committee, can help lengthen out the Federal debt which is, to me, the first pressing problem of debt management. I do not think that a debt, properly managed that way, will result in any higher interest rates than you would have normally.

Senator HARTKE. Thank you.

The CHAIRMAN. Senator Hartke, the Chair is not conscious that he has made any prediction that we will always have high interest rates.

Senator HARTKE. I did not mean to infer that.

The CHAIRMAN. That is what I understood you to say.

Senator HARTKE. I said I understood the chairman's position—I understood the chairman's position was by this action what you were doing was putting a floor on the long-term rate of interest.

The CHAIRMAN. I assume you are referring to refunding; advance refunding.

Senator HARTKE. That is right.

The CHAIRMAN. That is an entirely different question.

The Chair took the position, and still takes it, that you cannot predict 10 years from now or 20 years from now what the interest rate will be and, in his judgment, interest is more or less a commodity and is governed by the law of supply and demand of the money.

Do you agree with that?

Mr. WALKER. I agree with that, that the interest rate is a reflection of supply and demand for money.

The CHAIRMAN. The Chair was opposed to or was critical of this refunding whereby you take bonds that were 2.5 percent, and before they were due, 10 years before they were due, and replace them with bonds that paid 3.5 percent, and then you could do the same thing with these particular bonds 10 years from now, and the Chair thought if they purchased the bonds at 2.5 percent, that that figure should continue until the bonds matured. That was the basis for what I said.

I am not looking forward with any anticipation or any desire for higher interest rates any more than the law of supply and demand will require. That is what the Senator understood.

Senator HARTKE. I understood.

The CHAIRMAN. Any further questions?

Senator KERR. I would like to ask one question. The Senator from Illinois was talking to you about the reserves a bank had to have with the Federal Reserve in order to determine the amount or the extent of its lending capacity. The question was asked as to the relationship of the Federal bonds owned by the banks, and, I believe, you answered that they had no relationship to the reserves.

Mr. WALKER. Not legally; no, sir.

Senator KERR. And the deposit of Federal bonds by a member bank with the Federal Reserve System does not increase its reserve which determines its lending capacity or limits?

Mr. WALKER. No, sir. I did not say that or did not mean to imply that. The member banks can, among other methods, borrow from the Federal Reserve banks and get extra reserves, and Federal bonds can serve as security for such loans.

Senator KERR. I understand that.

Mr. WALKER. So can commercial——

Senator KERR. I was not referring to that operation.

Mr. WALKER. No, sir.

Senator KERR. I was referring to what I understood him to say, that the deposit of the bonds by the member banks with the Federal Reserve would in some way affect its effective reserves, and if it did I wanted to know about it. I did not know about it.

Mr. WALKER. I did not understand that from the Senator's statement.

Senator KERR. The only way that I understand that a bank can have a reserve in the Federal Reserve System is to make a deposit of funds that it has or borrow from the Federal Reserve by discounting notes that it has.

Mr. WALKER. Or on Government securities.

Senator KERR. Sir?

Mr. WALKER. Excuse me, or on Government securities as collateral.

Senator KERR. Or borrowing money from the Federal Reserve with Federal bonds as collateral.

Mr. WALKER. Yes, sir.

Senator KERR. Are those the three ways that create reserves? Is there any other way they can create a reserve?

Mr. WALKER. They cannot overtly create a reserve. They have reserves created partly——

Senator KERR. Is there any other way they can get a reserve?

Mr. WALKER. Yes, sir. If their customers decide to hold less cash, less $20 bills, and so on, and deposit those in the bank and build up their bank accounts, the commercial banks will send those funds to the Federal Reserve bank, and the reserves will be increased.

Senator KERR. Well, they deposit it in the Federal Reserve.

Mr. WALKER. That is correct.

Senator KERR. Well, that is what I said; they deposit funds in the Federal Reserve and get reserves; they discount notes to the Federal Reserve, which constitutes reserves, or they borrow money from it directly.

Mr. WALKER. Yes, sir.

Senator KERR. And there is no other way to get a reserve?

Mr. WALKER. No, sir. They may have more to lend if the Federal Reserve reduces the percentage requirements.

Senator KERR. I understand it, but they would lend it on the basis of their reserves and the relationship the Federal Reserve prescribes the reserves shall have to their lending capacity.

Mr. WALKER. Yes, sir.

Senator KERR. Now, you said the banks could create money, not credit. Did I understand you to say that?

Mr. WALKER. Yes, sir. But I would not push this. It is mainly a definitional distinction.

Senator KERR. I just wanted you to define money.

Mr. WALKER. I define money as that which is generally acceptable in exchange for goods and services. That would include both bank demand deposits and the currency which is issued by the Federal Government.

Senator KERR. Do you happen to have any currency in your pocket?

Mr. WALKER. Yes, sir.

Senator KERR. I wonder if you would lay a piece or two of it up on the table and see what it says.

Mr. WALKER. Yes, sir.

Senator KERR. Maybe a $1 and a $5 and a $10 and a $20.

Mr. WALKER. Well, they say different things.

Senator KERR. Let us see what they say.

Mr. WALKER. The $5 bill states—this particular $5 bill is a silver certificate.

Senator KERR. What does it say?

Mr. WALKER. It says that—

This certifies there is on deposit in the Treasury of the United States of America $5 in silver payable to the bearer on demand.

Senator KERR. Is that correct?

Mr. WALKER. Yes, sir.

Senator KERR. Wasn't there an action taken recently that changed that situation some?

Mr. WALKER. I do not believe so with respect to these particular $5 bills. There are still five silver dollars or $5 of bullion there valued at the official price. They discontinued their sales of silver, I believe, which——

Senator KERR. But you can still go down and get five silver dollars for that?

Mr. WALKER. Yes, sir.

Senator KERR. And that is what you could get with that?

Mr. WALKER. Yes, sir.

Senator KERR. Then that is a piece of paper with reference to which you could get what is sometimes called hard money or hard cash for it?

Mr. WALKER. Yes, sir.

Senator KERR. All right. Now, what other kind of notes are there, what other kinds of cash or bills do you have?

Mr. WALKER. I think I have a Federal Reserve note for $10; yes.

Senator KERR. What does it say?

Mr. WALKER. It says—

The United States of America will pay to the bearer on demand $10.

Senator KERR. Suppose you took that down to the U.S. Treasury and demanded the $10. What would you get?

Mr. WALKER. They could give me any sort of legal tender. I think legally they could give me my note right back.

Senator KERR. Well, could they give you anything else except that or another one like it?

Mr. WALKER. They could give me pennies, nickels, dimes, silver certificates, U.S. notes.

Senator KERR. If they had them.

Mr. WALKER. Yes, sir.

Senator KERR. There is a very limited amount of silver certificates, is there not?

Mr. WALKER. Yes, sir; they are limited. I do not remember the total figure.

Senator KERR. Well, the total currency outstanding is how much?

Mr. WALKER. It is around $30 billion in circulation. I would have to check the exact figures.

Senator KERR. What percentage of it is in the form of silver certificates?

Mr. WALKER. The percentage in value is very small. The percentage of the number of pieces because of the number of $1 and $5 certificates is very large.

Senator KERR. I understand. I am talking about the total.

Mr. WALKER. I would have to check that. It is small.

Senator KERR. It is not over 10 percent, is it?

Mr. WALKER. I would doubt that it is over 10 percent. We will have it in just a moment.

U.S. currency outstanding, silver certificates are a little better than $2 billion.

Senator KERR. It is about 6⅔ percent.

Mr. WALKER. Yes, sir.

Senator KERR. Now outside of Federal Reserve notes, what other kinds of currency are there?

Mr. WALKER. The only other kind of current currency, you might call it, I think, is the U.S. note, the old greenback of the Civil War days.

Senator KERR. That is what Lincoln issued during the Civil War. It is still outstanding.

Mr. WALKER. Yes, sir; in the amount of——

Senator KERR. That is something under $100 million, is it not?

Mr. WALKER. No, sir. I believe it is larger than that, $347 million maximum.

Senator KERR. $347 million. U.S. notes?

Mr. WALKER. Yes, sir.

Senator KERR. Have you got one of them?

Mr. WALKER. I do not know. They are red seal $5 bills; also $2 bills are U.S. notes.

Senator KERR. Here is one of them, Mr. Reporter, be sure that I get it back.

Mr. WALKER. Yes, sir.

Senator KERR. What does it say?

Mr. WALKER. It says the same as the others. It says:

The United States of America will pay to the bearer on demand $5.

Senator KERR. Now, what other kind of currency is there?

Mr. WALKER. Well, there are still technically in circulation some old types of currency which are obsolete, but have not been pulled out of circulation.

Senator KERR. Which have not been sent in for exchange, such as national bank notes.

Mr. WALKER. National bank notes.

Senator KERR. I saw one the other day, and what did they say?

Mr. WALKER. Sir, I do not know what the national bank notes say.

Senator KERR. Well, the point I am getting around to is this: Is that anything but a demand note?

Mr. WALKER. No, sir. I would say you are right. It is a demand note.

Senator KERR. And nothing else?

Mr. WALKER. Yes, sir.

Senator KERR. And, therefore, if that is money it is a form of credit, is it not?

Mr. WALKER. Yes, sir.

Senator KERR. So that actually neither the Federal Reserve bank nor any member of it can create anything but credit.

Mr. WALKER. I would not quarrel with that.

Senator KERR. Because even if it could create money of the kind that they put out, that within itself is a form of credit.

Mr. WALKER. Yes.

Senator KERR. And is nothing but a demand note; isn't that correct?

Mr. WALKER. Yes, sir.

Senator KERR. Non-interest-bearing demand notes.

Mr. WALKER. Yes, sir.

Senator KERR. That and nothing more.

Mr. WALKER. Yes, sir.

Senator KERR. That is all.

Senator DOUGLAS. Will the Senator yield?

Senator KERR. Yes.

Senator DOUGLAS. I am glad to have the Senator from Oklahoma establishing the particular identity of what is currency and what is credit.

May I say if the Senator from Oklahoma will pay me in return for a sale of goods, I will be glad to accept a check for $100 and deposit it and treat it just as I would five $20 bills.

Senator KERR. I appreciate that vote of confidence, but I would say this to him, that if I wrote a check on a bank, and it were valid, it would be because the bank owed me the money, which is credit, and if I gave the check to the Senator and he accepted it, it would be a form of credit, and if he took it down to the bank and got five $20 bills for it, that would just be another form of credit. If he got a deposit slip for it from the bank that would be just another form of credit.

Senator DOUGLAS. The Senator from Illinois does not dispute the position of the Senator from Oklahoma.

Senator KERR. So that actually we operate our economy on the basis of a managed system of credit, the fountainhead of which is the Federal Reserve System, correct?

Mr. WALKER. Yes, sir. Our monetary system is a credit system under the Federal Reserve System.

Senator KERR. Well, our monetary system is a credit system. Our bank deposit system is a credit system; our savings and loan deposit system is a credit system; our economy, the life, the stream of or flow of that which keeps this economy operating, is managed credit.

Mr. WALKER. Yes, sir.

Senator KERR. Created, managed credit, and the fountainhead of that is the Federal Reserve System.

Mr. WALKER. Senator, I know you do not want to get into a long discussion of the finer points of this. That portion of the credit system which is reflected in, say, bank demand deposits is definitely under the influence of the Federal Reserve or montetary authorities. But each year the amount of credit that changes hands and, in a sense, is created in other institutions such as the savings and loans and so on, and the insurance companies, the many hundreds of billions of dollars of credit of that type, are not under the direct influence or control of the Federal Reserve System.

Senator KERR. But it is the use of credit which was created by the Federal Reserve System.

Mr. WALKER. It was created at some stage as a basis of money.

Senator KERR. In the record of the operations of the Federal Reserve System.

Mr. WALKER. Yes, sir.

Senator KERR. And that is the only way it was created; that is the only way it retains its identity as credit, and the only way it can be augmented is by the operation of the Federal Reserve System and its member banks, of course. But they operate in accordance with the rules and decisions of the Federal Reserve System.

Mr. WALKER. With respect to the monetary portion; yes. Credit can come into existence, though, without action of the Federal Reserve.

Senator KERR. Well, how?

Mr. WALKER. Well, sir, you and I could draw notes on each other and endorse them and agree to sell them to somebody who trusted your credit or my credit.

Senator KERR. All right. What would we agree to pay?

Mr. WALKER. We could agree to pay these paper dollars we were talking about.

Senator KERR. Or we could agree to pay dollars. When we went to get them to pay them we would have to get them with what was made possible by the credit of the Federal Reserve operation, wouldn't we?

Mr. WALKER. In that respect I agree fully.

Mr. WELMAN. Mr. Chairman, may I make only one point for the record, that when I speak of banks creating money that is strictly in the sense of money that is used in exchange normally. A legal definition of money would be confined to paper money and coin.

The CHAIRMAN. The Chair thanks the witnesses. They have been frank and well-informed.

Senator MORTON. Could I ask one question, very briefly?

The CHAIRMAN. Yes.

Senator MORTON. Pursuing the point Senator Hartke made, when was this change made in commercial banks?

Mr. WALKER. Effective January 1.

Senator MORTON. January 1. So really you have only had 3 months in which to get this mortgage operation going?

Mr. WALKER. Yes.

Senator MORTON. Isn't it a fact that many banks have not been aggressive because they can find adequate earnings to meet their costs, interest costs and dividend requirements, elsewhere? But I just wanted to say I agree with you thoroughly that many banks—I know of many in Kentucky—are really becoming aggressive in the home mortgage field, and 3 months is a short time to get going. Most of them have had to go out and hire a specialist or find a man who was knowledgeable in this field.

Don't you think that according to the head of the savings and loan association and others that this is going to be a growing factor, and isn't it your judgment it will be if this rate structure continues as it is, it will be quite a growing factor?

Mr. WALKER. Very definitely, and in the ABA we are emphasizing this and trying to improve the flow of information to banks so they can do better in investing in mortgages.

Senator MORTON. Also since the tax-free municipals are not as attractively priced as they were 3 or 4 months ago, has not this sharp move into tax-free bonds been just because the yield is not as attractive, gone down, diminished?

Mr. WALKER. I am not certain what has happened to the yield, but there is certainly a self-corrective there that would take place.

Senator MORTON. That is all, Mr. Chairman.

(The supplemental material on section 8 of Mr. Welman's statement follows:)

MEMORANDUM RE ANNUAL LOSS DATA, COMMERCIAL BANKS AND MUTUAL FINANCIAL INSTITUTIONS, 1930–60

In discussions relating to the appropriate level of bad-debt reserves for mutual financial institutions considerable use has been made of aggregate loss data, particularly for the period 1930–45. Thus, the fact that mutual institutions took losses equal to approximately 15 to 20 percent of their loan portfolios during this period is frequently cited as justification for the present statutory bad-debt reserve allowance.[1] However, little or no information has been provided on an annual basis, apart from the suggestion that annual averages based on the full period are inappropriate because the losses of mutual institutions are concentrated in a few years of the cycle.[2] This memorandum provides annual data for the period 1930–45, as well as for the most recent 10-year period, in an effort to throw light on: (1) the comparative loss of commercial banks and the mutual institutions; and (2) the extent to which losses are bunched in the case of each type of institution.

Loss data, 1930–45.—The attached schedule A provides comparative loss data on loans, annually, for the three principal types of financial institutions competing for savings. For commercial banks and savings and loan associations the data were obtained from the authoritative study by Raymond W. Goldsmith "A

[1] "Taxation of Mutual Savings Banks and Savings and Loan Associations: Hearings Before the Ways and Means Committee," Aug. 9 and 10, 1961. See particularly the statement by Henry A. Bubb, U.S. Savings & Loan League, p. 72, and Edward P. Clark, National Association of Mutual Savings Banks, p. 150.

[2] See, for example, the statements by Charles A. Wellman, National League of Insured Savings Associations (hearings, op. cit., p. 328), and by Mr. Clark: "Losses are usually concentrated in a few years of a long cycle. Reserves must be built up in good years to meet the large losses which we know will occur in the depression years of the cycle" (hearings, op. cit., p. 143).

Study of Savings in the United States"; for mutual savings banks data were obtained from Prof. John Lintner's "Mutual Savings Banks in the Savings and Mortgage Market," a study proposed and financed by the Mutual Savings Banks Association of Massachusetts.[3]

The tabulations relate only to operating institutions and, so far as possible, to losses on loans. Thus, the loss picture is not complete, particularly for commercial banks in view of the thousands of failures during the depression and the very heavy losses taken at that time on securities.[4] Nevertheless, the annual loan loss figures for operating institutions probably provide the most accurate measure of the needed bad-debt reserve today.

It will be noted that for the full period 1930–45 losses taken by commercial banks were equal to 13.8 percent of the average loan portfolio, whereas the losses of the mutual institutions, on the same basis, are somewhat higher; 15.2 percent for savings and loan associations and 17.5 percent for mutual savings banks.[5] Differences among the three types of institutions are slight when the data are placed on an annual average basis for the full period 1930–45; losses were 0.9 percent of loans for commercial banks; 0.9 percent for savings and loan associations; and 1.1 percent for mutual savings banks.

The most revealing piece of information shown in schedule A is the concentration of losses in the case of commercial banks, contrasted with the ability of the mutual institutions (particularly the mutual savings banks) to spread their losses over a much longer period of time. Thus, during the 5 worst years of the period—1930 to 1934—commercial bank losses were equal to 8.9 percent of the average loan portfolio, whereas for savings and loan associations the loss during this period was 4.9 percent, and for mutual savings banks only 2.1 percent. Indeed, the heaviest losses were not taken by mutual savings banks until 1942–43, almost a full decade after the bottom of the depression.

It should also be noted that in no single year—including the worst years of the depression—did the mutual institutions suffer a loss in excess of 2.9 percent of loans. The worst loss year for savings and loan associations was 1935, when losses were equal to 2.2 percent of mortgage loans. For mutual savings banks the largest loss ratio was 2.9 percent, in 1943. In no year of this period from 1930 to 1945 did the losses of the mutual institutions ever approximate the bad-debt reserve level presently provided by statute— equal to 12 percent of deposits or, expressed in terms of loans, about 12.5 percent of savings and loan association loans and 16 percent of mutual savings banks loans in 1960. By way of contrast, in each of 2 years—1933 and 1934—commercial bank losses on loans were larger, relative to the loan portfolio, than the bad-debt reserve of 2.4 percent now permitted, on the average, for all commercial banks.

It is clear that the needed size of a bad-debt reserve depends on both the magnitude and timing of the losses it must absorb. Thus, for example, when Professor Lintner concluded that the depression experience might justify a loss reserve for mutual savings banks of from 5 to 8 percent of uninsured loans (a level far below the present statutory bad-debt limit), he qualified his conclusion by pointing out that the length of the real estate cycle made it unnecessary to

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[3] Raymond W. Goldsmith, "A Study of Savings in the United States" (Princeton, 1955). vol. I; John Lintner, "Mutual Savings Banks in the Savings and Mortgage Market" (Boston, 1948).

[4] During the 4 years 1930–33 almost 9,000 commercial banks suspended operations, most of which remained permanently closed (FDIC Annual Report for 1960, p. 32). Failures of mutual savings banks were negligible, totaling 10 during this period (Federal Reserve, "Banking and Monetary Statistics," p. 292) and failures of savings and loan associations during the 4 years 1930–33 numbered 526 ("Savings and Loan Annals," 1937, p. 367). Failed commercial banks during these years held about 18 percent of deposits in all operating banks at the beginning of the period and losses to depositors alone totaled $1.4 billion (FDIC Annual Report for 1957, p. 64). Total losses were probably twice this amount, judging from the fact that, for the full period 1921–33, losses to stockholders in closed banks were somewhat larger than losses to depositors (FDIC Annual Report for 1940, p. 62). During the 4-year period 1930–33, operating commercial banks had net losses of $1 billion on securities, accounting for about 86 percent of total net losses (Goldsmith, op. cit., p. 651).

[5] It will be noted that mutual savings bank data relate only to Massachusetts savings banks. Annual data provided in the Goldsmith study for all mutual savings banks are not considered reliable by Goldsmith, who states "No special significance should be attached to [them]" (Goldsmith, op. cit., vol. II, p. 258). The Massachusetts data should be reasonably representative of the industry.

have the full amount of even this reserve on hand at the beginning of the cycle.[6] It is, therefore, quite apparent from schedule A that the bad-debt reserve now provided for the mutual institutions is excessive. Put another way, if a reserve limit of 12 percent of deposits can be justified for the mutual institutions on the basis of the foregoing data, then a considerably larger bad-debt reserve is justified for the commercial banks, who took very heavy loan losses over a brief period of time.

Loss data, 1951–60.—Schedule B shows losses on loans taken by insured commercial banks and insured mutual savings banks during each of the 10 years 1951 to 1960.[7] Comparable data are not available for savings and loan associations.

Loan losses have been extremely small during this period, averaging about one-tenth of 1 percent of loans, per year, for insured commercial banks and three one-thousandths of 1 percent of loans for insured mutual savings banks. However, although small for both types of institutions, it is apparent that losses taken by commercial banks are substantially larger, relative to total loans, than is the case for mutual savings banks. This is true for the period as a whole and for each year within the period.

Schedule B also shows losses as a percentage of total deposits. It is of interest, therefore, that whereas mutual savings banks are permitted a bad-debt reserve which can be as large as 12 percent of deposits, the average annual loss on mortgage loans taken by these institutions has been only two one-thousandths of 1 percent. The largest loss year was 1952, when losses were equal to only five one-thousandths of 1 percent of deposits.

Housing and Taxation

An analysis of the effect on the availability of mortgage funds of the taxation of mutual savings institutions

During the past year, spokesmen for the mutual savings industry have asserted that regular taxation of the savings and loan associations and mutual savings banks will have serious adverse effects on the availability of funds for residential mortgages. As signs multiply that the Congress and the administration are determined to enact long-needed tax reforms, this housing argument has been pushed to the forefront almost to the exclusion of the traditional arguments advanced to protect the mutuals from assuming their share of the Nation's tax burden.

In capsule form, the mutuals' argument is as follows: Payment of taxes by savings and loans and mutual savings banks will require a substantial reduction in the dividend or interest rate; the figure most frequently cited is one-half of a percentage point. Such a reduction, it is alleged, will make mutual institution accounts relatively less attractive and thus will divert a substantial volume of new savings from these institutions to other savings media. The amount of the diversion is roughly estimated by mutual spokesmen at upward of $6 billion per year. Almost all of the amount diverted will be lost to the housing industry, the argument continues, since it will go either to savings media which do not invest in residential mortgages—such as U.S. savings bonds—or to commercial banks which invest, according to mutual spokesmen, only about 30 percent of savings in residential mortgages. Finally, and most recently, mutual spokesmen have claimed that the recent increase in maximum permissible rates which banks can pay on savings has already begun to divert funds from their institutions, so that the impact of taxation will have an even greater adverse impact on the availability of mortgage money.

Commercial bankers reject the foregoing argument entirely, believing honestly that it represents nothing more than an attempt to frighten the Congress into

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[6] Lintner, op. cit., p. 326.

[7] Loan data for mutual savings banks relate to mortgage loans, which comprise more than 98 percent of total loans in mutual savings banks.

taking no action on the administration's proposal for fair taxation of the mutual savings industry. The mutuals' argument—

(1) Is an undisguised plea for continued subsidy through the tax mechanism;

(2) Exaggerates the effect of taxation on the mutual thrift institutions;

(3) Ignores the relationship between housing and economic activity generally;

(4) Ignores the fact that there is no present shortage of housing funds, nor is there any anticipation of a shortage;

(5) Understates the contribution which commercial banks make to the housing industry; and

(6) Overlooks the fact that the recent change in interest rate ceilings for commercial banks will substantially increase the flow of funds to the mortgage market.

This paper discusses briefly each of these points.

1. Tax subsidy.—Reduced to its essentials, the mutual argument with respect to housing is simply a demand for the continued subsidy of certain types of financial institutions. Thus, the argument could be restated, as follows: "We enjoy a Government subsidy to the extent that we are permitted to operate virtually tax free. In return for this subsidy, we operate in such a manner as to divert a large part of the Nation's savings to ourselves, and then into real estate mortgages. If our subsidy is taken away, we either will not or cannot carry out our part of the bargain."

Subsidies for various purposes are not unusual, and in some cases may be warranted. But if so, they should be open and aboveboard; not hidden in the tax structure. Certainly, a subsidy which favors some but not all of a group of competitive institutions is inequitable.

2. Effect on dividends and savings.—Taxation will have some effect on the mutual institutions, just as it affects any profitmaking business. However, all available evidence indicates that the mutual institutions will be able to adjust to taxation without the need for drastic cuts in dividend rates. As a matter of fact, because net income of these institutions is increasing faster than savings (due to reinvestment of maturing mortgages at currently higher yields), it is unlikely that taxation will have any noticeable effect on dividend rates paid by most institutions.

This conclusion as to the impact of taxation on mutual institution dividends was recently confirmed by Treasury Department analysts. In a letter to Representative Keogh on February 7, the Treasury, in discussiong the effect of an equitable tax formula on mutual institutions, stated:

"The possible effects on dividends and interest rates do not appear to be large enough to affect appreciably the growth in savings and share accounts. Moreover, given the anticipated increase over the next few years in average rate of return on mortgages, *is it very likely that any effect on interest or dividend rates will appear as a smaller increase in yields to depositors rather than as an absolute decline in yields.*" [Italic added.]

3. Relationship between housing and general economic activity.—The mutual argument pays no attention to the fact that a complex economic system must, if it is to be prosperous, depend on financial institutions for prompt and effective allocation of funds. It further ignores the fact that the housing industry is an integral part of the economy; that it can only prosper when the economy is prosperous and growing. The crucial fault of the present method of taxing financial institutions is that, by permitting the mutual institutions to operate virtually tax free, it promotes the diversion of savings from sectors of the economy which funds may be badly needed to those institutions which, for the most part, can only invest in a specific type of obligation. Thus, tax favoritism enjoyed by the mutual institutions is basically detrimental to housing and to every other industry, since it introduces rigidities and distortions into the working of our free enterprise system.

4. Availability of housing funds.—When opposing tax reform and raising the specter of a shortage of housing funds, mutual spokesmen often neglect to point out that, if anything, there is a surplus of money available for housing at the present time and, indeed, a surplus is anticipated over the next decade. This

is due in part to the fact mentioned above: that the tax systems operates in such a manner as to artifically divert a portion of the Nation's savings into certain industries, regardless of the need for funds.

Projects prepared by the Housing and Home Finance Agency indicate that during the decade of the 1960's there will be an excess supply of mortgage funds in each year and that, for the full 10 years, the excess supply will amount to more than $20 billion. Recently the president of the U.S. Savings & Loan League noted that, "the real, basic housing demand has been satisfied for the present. * * * [Savings and loan associations face the] * * * question of where the loans are going to come from to keep our money invested."

For much of the past year, savings and loan associations have been investing an increasing proportions of savings in real estate loans other than those for the construction or purchase of home, indicating again the ready availablity of home mortgage funds. The Federal Home Loan Bank Board has repeatedly called attention to this fact as, for example, in its January 1962 release:

"The most accelerated gain in mortgage activity during the opening month of 1962 was reported for miscellaneous lending, a pattern evident since the summer of 1960. Loans for a variety of purposes, such as financing alterations or refinancing of existing home loans, financing apartments or land development, etc., together increased by almost three-fifths over January 1961 and comprised one-third of overall lending contrasted with 29 percent in the previous year."

It is ironical that the mutual spokesmen feel compelled to raise the specter of a shortage of housing funds as a time when they, themselves, are seeking outlets for the investment of their savings.

5. *Commercial bank activity in the housing field.*—Because commercial banks are not special purpose lenders, investing almost entirely in residential mortgages, the mutual savings institutions have claimed that any diversion of savings to the commerical banks will be detrimental to the housing industry. What is overlooked in their argument is the fact that commercial banks engage in a variety of activities which are of direct concern to the welfare of the housing industry and to the well-being of American homeowners.

The commercial banks have invested $20 billion in residential real estate mortgages and, in addition, have placed a substantial volume of funds in farm mortgages and in other types of real estate mortgages. Also, commercial banks are making an increasing volume of residential repair and modernization installment loans. But, beyond this, commercial banks serve as an important source of funds for institutions and agencies directly concerned with the housing industry. For example: The major share of the $10 billion invested by the commercial banks in State and municipal obligations goes for such things as streets, schools, and sewage systems; commercial banks provide a substantial portion of the working funds used by mortgage companies who originate a large percentage of residential mortgages, particularly VA and FHA mortgages; the construction industry depends to an important degree on commercial banking for its financing.

6. *Change in commercial bank interest rate ceilings.*—Despite claims of the mutual spokesmen that the recent change in the maximum permissible rates that commercial banks can pay on savings will adversely affect the mutuals' ability to attract savings, recent reports from the Federal Home Loan Board show that savings and loan associations are continuing to maintain a rapid rate of growth. In January and February, the first 2 months following the change in commercial bank rate ceilings, new savings capital received by savings and loan associations reached successive peaks. Net savings growth (i.e., after giving effect to withdrawals) was substantial in January, although down from the preceding January. In February, according to the Federal Home Loan Bank Board, net savings growth reached an estimated $560 million, 5 percent greater than that reported for the same month last year, and the largest amount for any February of rates.

If mutual savings spokesmen are sincerely concerned over the availability of funds for housing, they should welcome the recent action by supervisory authorities in raising maximum permissible rates which commercial banks can pay on savings. Far from adding to the supposed "problem," this action should provide significant additional funds for residential mortgages. Many commercial banks, faced with higher costs because of increased savings rates, are being compelled to move more aggressively into the residential mortgage area in order to obtain the needed higher yields.

This conclusion is based on more than theory. The American Bankers Association has received numerous reports of commercial banks actively seeking ways and means of investing a larger proportion of savings in mortgages. The financial press is now beginning to reflect this story which, as a matter of fact, may be the most dramatic development in the residential mortgage market in 1962. Thus, the Wall Street Journal commented on the impact of higher rates on savings in the following manner:

"Commercial banks, paying in some cases a full percentage point more now than they were last year, are themselves looking for higher yielding investments to compensate for this increase. As a result, many banks are moving much deeper into the mortgage market than they ever ventured before" (Jan. 8, 1962).

In another report, a large New York City bank was described as expanding its home mortgage loan service by accepting, for the first time, applications for home mortgages at the personal credit department at each of the bank's 90 branches. As the Journal pointed out: "The bank said it is stepping up its mortgage lending to channel for use by homeowners a larger portion of its savings deposits. * * * Mortgages yield higher returns than most other long-term investments of banks; returns will be applied to the bank's increasing interest costs" (Jan. 11, 1962).

But perhaps the most convincing evidence of the real impact of the recent charge in bank interest rates is the reaction of savings and loan associations. In a speech on March 1, 1962 before savings and loan executives, the president of the U.S. Savings and Loan League conceded that "associations did not do too badly" in the competition for savings since the change is permissible in commercial bank notes. He then went on to point out that commercial banks were aggressively seeking mortgages and stated: "Competition from the commercial banks in the home mortgage field may be more serious to associations than the new bank savings rates" (American Banker, Mar. 2, 1962).

Conclusion.—The housing argument advanced by mutual spokesmen has no justification on economic grounds and, in fact, has no relevance to the tax question. In essence, it is a last-ditch effort to avoid taxes, based on an exaggerated appraisal of tax impact and a gross understatement of the very significant contribution which commercial banking makes to the prosperity and vitality of the housing industry. It should not be permitted to obscure the basic question: How much longer should a $125-billion industry operate virtually tax free?

Federal income tax paid by FHLB member savings and loan associations in metropolitan areas with 5 or more associations, 1960

[Full dollar amounts]

State and metropolitan area	Number of associations	Net income [1]	Federal income tax paid	
			Total	Per institution (average)
Alabama: Birmingham	10	$1,605,000	$1,000	$100
Arizona: Phoenix	5	1,601,000	5,000	1,000
Arkansas:				
Fort Smith	5	304,000	0	0
Little Rock-North Little Rock	6	623,000	0	0
California:				
Los Angeles-Long Beach	105	74,069,000	301,000	2,867
Sacramento	7	2,224,000	8,000	1,143
San Bernardino-Riverside-Ontario	16	2,975,000	57,000	3,563
San Diego	13	8,596,000	23,000	1,769
San Francisco-Oakland	37	15,744,000	486,000	13,135
San Jose	10	8,995,000	59,000	5,900
Stockton	5	780,000	23,000	4,600
Colorado: Denver	19	5,437,000	6,000	316
Connecticut:				
Bridgeport	5	149,000	2,000	400
Hartford	8	1,165,000	1,000	125
Delaware: Wilmington, Del.-N.J	9	414,000	0	0
District of Columbia: Washington, D.C.-Md.-Va	44	9,402,000	([footnote])	....
Florida:				
Fort Lauderdale-Hollywood	5	3,483,000	0	0
Jacksonville	7	1,222,000	0	0
Miami	15	10,845,000	0	0
Orlando	7	2,717,000	1,000	143
Tampa-St. Petersburg	12	5,152,000	1,000	83
West Palm Beach	7	1,914,000	0	0
Georgia:				
Atlanta	19	4,743,000	20,000	1,053
Augusta, Ga.-S.C	5	437,000	0	0
Columbus, Ga.-Ala	5	427,000	12,000	2,400
Hawaii: Honolulu	7	1,994,000	0	0
Illinois:				
Champaign-Urbana	7	282,000	1,000	143
Chicago	266	36,198,000	50,000	188
Peoria	15	1,980,000	5,000	333
Springfield	10	379,000	11,000	1,100
Indiana:				
Evansville, Ind.-Ky	9	806,000	5,000	556
Gary-Hammond-East Chicago	18	1,349,000	45,000	2,500
Indianapolis	16	1,590,000	17,000	1,063
South Bend	7	681,000	0	0
Terre Haute	6	233,000	0	0
Iowa:				
Davenport-Rock Island-Moline, Iowa-Ill	0	788,000	0	0
Des Moines	9	1,663,000	0	0
Waterloo	6	579,000	0	0
Kansas:				
Topeka	5	2,365,000	0	0
Wichita	9	443,000	16,000	1,778
Kentucky: Louisville, Ky.-Ind	11	2,141,000	0	0
Louisiana:				
Baton Rouge	7	445,000	0	0
New Orleans	32	4,385,000	0	0
Maine: Portland	8	209,000	67,000	8,375
Maryland: Baltimore	66	7,556,000	35,000	530
Massachusetts:				
Boston	101	6,998,000	55,000	545
Brockton	7	507,000	0	0
Lawrence-Haverhill Mass.-N.H	9	335,000	0	0
Springfield-Chicopee-Holyoke	10	345,000	0	0
Michigan: Detroit	21	8,558,000	2,000	95
Minnesota:				
Duluth-Superior, Minn.-Wis	5	509,000	0	0
Minneapolis-St. Paul	18	8,420,000	46,000	2,550
Missouri:				
Kansas City, Mo.-Kansas	28	3,497,000	33,000	1,179
St. Louis, Mo.-Ill	73	8,732,000	2,000	27
Springfield	5	851,000	0	0
Nebraska: Omaha, Nebr.-Iowa	7	1,116,000	3,000	429
New Jersey:				
Atlantic City	5	492,000	0	0
Jersey City	14	2,392,000	0	0
Newark	73	7,833,000	0	0
Paterson-Clifton-Passaic	52	5,457,000	1,000	19
Trenton	13	483,000	7,000	538

See footnotes at end of table.

Federal income tax paid by FHLB member savings and loan associations in metropolitan areas with 5 or more associations, 1960—Continued

[Full dollar amounts]

State and metropolitan area	Number of associations	Net income [1]	Federal income tax paid: Total	Federal income tax paid: Per institution (average)
New York:				
Albany-Schenectady-Troy	10	$957,000	0	0
Buffalo	18	971,000	$101,000	$5,611
New York City	102	26,045,000	57,000	559
Rochester	6	1,556,000	6,000	1,000
Syracuse	7	540,000	1,000	143
Utica-Rome	6	387,000	1,000	167
North Carolina: Greensboro-High Point	6	686,000	0	0
North Dakota: Fargo-Moorhead, N. Dak.-Minn	5	501,000	1,000	200
Ohio:				
Akron	10	1,768,000	52,000	5,200
Canton	13	1,485,000	13,000	1,000
Cincinnati, Ohio-Ky	197	6,347,000	138,000	701
Cleveland	40	13,819,000	66,000	1,650
Columbus	20	3,433,000	87,000	4,350
Dayton	23	2,548,000	7,000	304
Hamilton-Middletown	8	906,000	0	0
Steubenville-Weirton, Ohio-W. Va	5	436,000	55,000	11,000
Toledo	6	1,954,000	0	0
Youngstown-Warren	8	2,049,000	13,000	1,625
Oklahoma:				
Oklahoma City	11	1,929,000	2,000	182
Tulsa	8	1,099,000	3,000	375
Oregon: Portland, Ore.-Wash	12	2,106,000	1,000	83
Pennsylvania:				
Allentown-Bethlehem-Easton, Pa.-N.J	14	324,000	10,000	714
Altoona	9	337,000	1,000	111
Harrisburg	6	590,000	0	0
Johnstown	5	401,000	0	0
Philadelphia, Penn.-N.J	257	11,585,000	44,000	171
Pittsburgh	142	8,844,000	25,000	176
Reading	5	376,000	0	0
Wilkes-Barre-Hazleton	8	563,000	0	0
Rhode Island: Providence-Pawtucket, R.I.-Mass	9	1,196,000	0	0
South Carolina:				
Columbia	7	753,000	0	0
Greenville	6	641,000	0	0
Tennessee:				
Memphis	5	1,020,000	0	0
Nashville	6	1,499,000	0	0
Texas:				
Beaumont-Port Arthur	7	604,000	27,000	3,857
Dallas	25	3,030,000	55,000	2,200
Fort Worth	7	911,000	95,000	13,571
Houston	16	2,336,000	16,000	1,000
San Antonio	5	1,123,000	8,000	1,600
Wichita Falls	5	213,000	0	0
Utah: Salt Lake City	8	2,578,000	52,000	6,500
Virginia:				
Norfolk-Portsmouth	8	1,157,000	2,000	250
Richmond	5	862,000	0	0
Washington:				
Seattle	20	2,631,000	20,000	1,000
Spokane	5	1,459,000	0	0
Tacoma	5	1,674,000	0	0
West Virginia:				
Huntington-Ashland, W. Va.-Ky.-Ohio	10	657,000	5,000	500
Wheeling, W. Va.-Ohio	10	661,000	101,000	10,100
Wisconsin:				
Madison	6	1,317,000	0	0
Milwaukee	63	10,622,000	11,000	175
Racine	6	506,000	0	0
Total (member associations in metropolitan areas with five or more member associations)	2,556	419,537,000	2,478,000	969
Total (all member associations in the United States)	4,694	563,703,000	4,160,000	886

[1] Net income before Federal income tax but after payment of dividends.
[2] Less than $500.

NOTE.—Components will not add to totals due to rounding.

Source: Federal Home Loan Bank Board, "Combined Financial Statements, 1960."

SCHEDULE A.—*Losses on loans—Commercial banks, savings and loan associations, and mutual savings banks, 1930–45*

[Operating institutions]

Year or period	Commercial banks, net losses on loans		Savings and loan associations, net losses, total		Mutual savings banks (Massachusetts), net losses on mortgage loans	
	Amount [1] (millions)	Percent of total loans [2]	Amount [3] (millions)	Percent of mortgage loans [4]	Amount [5] (thousands)	Percent of mortgage loans [6]
1930	$235	0.7	$2	0.03	[7] $2,198	0.2
1931	357	1.2	43	.7	3,410	.3
1932	498	2.2	84	1.5	5,932	.5
1933	515	2.8	88	1.8	6,964	.6
1934	516	3.3	48	1.2	7,169	.6
Total, 1930-34 [8]	2,121	8.9	265	4.9	25,673	2.1
1935	243	1.6	76	2.2	8,390	.8
1936	143	.9	52	1.6	8,718	.8
1937	53	.3	32	1.0	9,151	.9
1938	95	.6	24	.7	9,334	.9
1939	72	.4	53	1.4	14,298	1.4
Total, 1935-39 [8]	606	3.7	237	6.9	49,886	4.8
1940	49	.3	59	1.5	16,530	1.7
1941	34	.2	43	1.0	19,301	2.0
1942	12	.1	35	.8	25,089	2.7
1943	+11	+.1	23	.5	25,916	2.9
1944	+14	+.1	23	.5	13,175	1.5
1945	+11	+.05	+6	+.1	6,902	.9
Total, 1940-45 [8]	59	.3	177	3.9	106,913	11.8
Total, 1930-45 [8]	2,786	13.8	679	15.2	182,472	17.5

[1] Raymond W. Goldsmith, "A Study of Savings in the United States" (Princeton University Press: 1955) vol I, "Capital Gains and Losses of Operating Commercial Banks," p. 651. Goldsmith's estimates very possibly understate commercial bank net losses. For example, FDIC data on net chargeoffs of operating commercial banks from 1930 through 1940 show total net chargeoffs of $5.5 billion, whereas Goldsmith's estimates of capital losses for the same period total $4 billion. The difference may be attributable to the fact that Goldsmith relied on Federal Reserve member bank loss data in preparing his estimates and these banks may have had a more favorable loss experience than nonmember banks. (See Annual Report of FDIC for 1940, p. 66, and Goldsmith, op. cit., p. 650.)

[2] Percent based on average of beginning and end of year total loans. Data from Goldsmith, op cit., p. 409.

[3] Goldsmith, op. cit., "Capital Gains and Losses of Operating Savings and Loan Associations," p. 445. Figures include $75,000,000 of surplus of closed associations and these overstate somewhat total losses for operating institutions. All losses are assumed here to be applicable to real estate loans since no breakdown is provided—as in the case of losses of commercial banks—of losses arising out of other assets.

[4] Percent based on average of beginning and end of year mortgage loans. Data from Goldsmith, op. cit., p. 436.

[5] John Lintner, "Mutual Savings Banks in the Savings and Mortgage Market" (Harvard University: 1948), pp. 283 and 304. Data relate only to Massachusetts mutual savings banks and represent amount shown by Lintner (p. 283) as "Total net losses on foreclosed real estate recognized during year" plus losses on loans not in foreclosure. The latter amount totaled $27,500,000 for the period 1931–45 (p. 304) and has been distributed here by year in the same annual proportions as losses on foreclosed real estate, for which annual data are available.

[6] Percent based on beginning and end of year real estate loans. Data from Lintner, op. cit., p. 275.

[7] Includes an estimated amount of losses on real estate not in foreclosure.

[8] Percentages computed by relating total losses for the period indicated to the annual average of loans outstanding during the period.

NOTE.—Memoranda: Average annual percent loss:

	Percent
Commercial banks	0.86
Savings and loan associations	.95
Mutual savings banks	1.09

SCHEDULE B.—*Loan loss experience of insured commercial banks and insured mutual savings banks, 1951–60*

[Amounts in thousands]

Year	Insured commercial banks			Insured mutual savings banks		
	Net losses and charge-offs on loans [1]	Net losses as percent of— Total loans and discounts [2]	Net losses as percent of— Total deposits [2]	Net realized losses on real estate mortgage loans [3]	Net losses as percent of— Total real estate mortgage loans [2]	Net losses as percent of— Total deposits [2]
		Percent	*Percent*		*Percent*	*Percent*
1960	$206,249	0.18	0.09	$1,208	0.005	0.004
1959	53,433	.05	.03	170	.001	.001
1958	61,056	.06	.03	594	.003	.002
1957	71,566	.08	.04	773	.005	.003
1956	92,068	.11	.05	422	.003	.002
1955	49,403	.07	.03	424	.003	.002
1954	44,366	.07	.03	[4](122)		
1953	58,925	.09	.03	[4](195)		
1952	34,732	.06	.02	837	.01	.005
1951	34,878	.06	.02	[4](212)		
Total, 1951–60	706,676	.09	.04	3,899	.003	.002

[1] Losses and chargeoffs on loans (including losses charged to reserve accounts) minus recoveries on loans (including recoveries credited to reserve accounts).
[2] Averages of figures reported at beginning, middle, and end of year.
[3] Realized losses on real estate mortgage loans (including losses charged to valuation adjustment provisions) plus direct writedowns on real estate mortgages, minus realized profits and recoveries on real estate mortgage loans (including recoveries credited to valuation adjustment provisions) plus negative writedowns on real estate mortgages.
[4] Realized profits and recoveries exceeded realized losses.

NOTE.—Comparable annual data are not available for savings and loan associations.

Source: Annual Reports of the Federal Deposit Insurance Corporation 1959–60. Data on direct writedowns for insured mutual savings banks provided by FDIC in a special tabulation.

The CHAIRMAN. The committee will recess until 2:30 this afternoon.

(Whereupon, at 12:30 p.m., the committee recessed, to reconvene at 2:30 p.m., this same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Reed H. Albig, Independent Bankers Association.

Take a seat, sir.

STATEMENT OF REED H. ALBIG, PRESIDENT, INDEPENDENT BANKERS ASSOCIATION; ACCOMPANIED BY RALPH L. ZAUN, CHAIRMAN, COMMITTEE ON SAVINGS AND LOAN ASSOCIATIONS; AND PAUL D. LAGOMARCINO, ATTORNEY, COUNSEL TO THE COMMITTEE ON SAVINGS AND LOAN ASSOCIATIONS

Mr. ALBIG. Thank you, Mr. Chairman.

May I present my associates who are with me. Mr. Ralph L. Zaun, who is executive vice president of the Grafton State Bank, in Grafton, Wis.; he is chairman of our Committee on Savings and Loan Associations; and Mr. Paul D. Lagomarcino, who is counsel to that committee, attorney in Washington.

My name is Reed H. Albig. I am president of the National Bank of McKeesport, Pa. I appear before you today as president of the Independent Bankers Association.

The Independent Bankers Association is a nationwide association of 6,000 independent community banks. Since 1930, the association

I represent has been the spokesman for the Nation's smaller banking institutions, presenting the thinking of American bankers at the grass-roots level.

My presentation shall be directed to two subjects:

A. The withholding provisions of H.R. 10650 established an unnecessarily complex and unwieldy machinery to correct a problem better solved by simpler means.

B. It is unfair virtually to exempt the mutual institutions—the savings and loan associations and mutual savings banks—from Federal income tax or to tax them, as would H.R. 10650, as if they somehow earned a dollar containing only 40 cents, when the banks with which they compete pay a heavy tax load on a dollar containing a full 100 cents. Furthermore, the virtual tax exemption of the mutuals restricts the ability of the commercial banker to serve the varied credit needs of his community and thereby limits flexibility in the financial structure of the Nation.

No matter has higher priority among the community bankers than achieving tax equality with the mutual institutions with which the bankers compete.

A. Let me discuss briefly the withholding of interest under H.R. 10650.

The withholding on interest creates many problems for the banking industry—the segregation of accounts, special treatment of accounts not withheld for those under 18, accounts not withheld for tax-exempt groups, accounts not withheld where no tax will be due for the year—although it may have to be withheld the year following—accounts of persons growing out of the under 18 group—to name a few.

All of these require a great amount of special and personal handling, and accordingly, time and expense—not only to set up the savings accounts to comply with the law initially, but attention and handling on a continuing day-to-day basis as the character of the accounts and the depositors change with the passage of time.

To any bank, and especially to the small community bank where income and staff are also small—sometimes a literal handful of employees only—the requirements of withholding constitute a substantial burden. Our member banks are extremely vocal in their opposition to it.

They feel that other alternatives exist which should be explored before withholding is imposed upon them. One alternative would be a simple question on the tax form requiring the taxpayer to indicate "Yes" or "No" if he had declared his income from interest. This would eliminate the argument that this income had not been declared due to oversight or ignorance. This method is currently used in the tax form in schedule C which asks the taxpayer if he claimed a deduction for expenses in connection with a pleasure boat, a fishing camp or a hunting lodge, or the like. Another question asks if a deduction was claimed for the attendance of the taxpayer's family at a business meeting or convention. This technique—which both makes the taxpayer aware of a possible tax problem and also flags the attention of the Internal Revenue Service to the manner in which it was handled—constitutes a less complicated answer to taxing interest than withholding.

We do not quarrel with the position taken by the Treasury Department that interest income should be effectively taxed. We do feel that other forms of income should be effectively taxed as well, however.

B. The income of the mutual savings banks and the savings and loan associations should be effectively taxed, too—just as the few dollars of interest income of the factory worker, the farmer, and the clerk. Why should these persons pay tax on 100 cents of every dollar of their small income when the savings and loans and mutual savings banks—a $125 billion industry—will have to pay tax on only 40 cents of every dollar of their two-thirds of a billion dollars a year income?

Furthermore, how can you expect the banker to welcome the prospect of being saddled with withholding on the one hand, and, on the other hand, in the very same bill find himself sorely discriminated against by having his competitor pay tax on only 40 cents of each dollar of his income?

H.R. 10650 in this respect is unjust and it is unrealistic in its present form.

None of the community banks are asking this committee to reduce the Federal income tax that the law requires them to pay. They do ask, however, that these requirements of the law be made to apply to their competitors as well as to themselves. Other financial institutions by their experience have shown it is possible to pay income tax on earnings, to build adequate reserves, and yet to pay attractive rates to savers.

It is our position that prompt action is necessary to correct the inequities which exist in the comparative tax positions of the commercial banks and the mutual institutions with which they compete for savings and for loans.

This fact was recognized by the Congress in 1951. The Revenue Act of 1951 was being considered under circumstances remarkably similar to those today. The 1951 act was drawn to increase revenues to help pay for national defense expenditures, then in Korea, instead of the global cold war commitments and Vietnams of today. The Congress then decided that the mutuals should pay tax as everyone else did.

However, the 1951 act did not achieve its goal. The revenue raised has been insignificant—only $6 million in 1960 from loan associations and less than one-half million from savings banks.

Today the need for revenue is as strong, if not more so, than it was 10 years ago. The Treasury estimate of July 1961 that tax equality would return over $400 million additional revenue in 1963 and over $500 million additional revenue in 1965 would go far to help meet that revenue need.

Furthermore, the discrimination is more in need of correction now than it was then, because since 1950 share accounts in savings and loan associations have more than quadrupled. This increase has been the result of the ability of the associations to pay higher rates for savings than to commercial banks and this in turn has been made possible largely by the associations' virtual freedom from paying income tax.

In the 10-year period between 1951 and 1960, the insured commercial banks paid total Federal tax of $9 billion, or at an effective rate of 40.8 percent of taxable income. In contrast, all insured mutual savings banks in this entire 10-year period paid total Federal income tax of only $10 million, or an effective rate of 0.8 percent of their taxable income.

During the same period, all savings and loan associations paid total Federal income tax of only $47 million on taxable income of $8.7

billion, or at a rate of 1.8 percent of taxable income. The combined tax paid by both types of mutual institutions during this 10-year period as a percent of their combined taxable income, averages only a little over 1.1 percent, as against the 40.8 percent paid by the commercial banks.

As the Treasury report of July 1961 on "The Taxation of Mutual Savings Banks and Savings and Loan Associations" states, this discrimination is not justified on any of the grounds which have been historically urged as the bases for continuing the tax exemption of the mutual institutions. Today, of all major financial institutions, the mutual savings banks and the savings and loan associations—with combined assets of $125 billion in 1961—were the only ones not paying their share of the Federal tax burden.

The competitive impact of the tax exemption of the mutuals can be measured by a comparison of their growth in assets with the growth in assets of commercial banks. Since the end of World War II, the savings and loan industry has doubled its assets approximately every 5 years—from $8.7 billion in 1945, to $16.8 billion in 1960, to $37.5 billion in 1955, to $82 billion at the end of 1961. In 1961 mutual savings banks had assets of $42.8 billion. Total assets for both types of institutions at the end of 1961 were about $125 billion.

Let us turn to the chart entitled "77 Times More Tax Is Paid by Banks" which is designated "Appendix A." You will recognize on the back of your papers that chart by the blue cover.

This chart provides important data at both the National and the State level.

At the national level, the chart shows that in the year 1960, the loan associations had a resource growth of 12.7 percent as against 3.9 percent for commercial banks. As you have been told, in 1960 member loan associations in the country paid total Federal income tax of only $4.2 million, as against $1.3 billion by commercial banks.

Let us next consider this question of competitive impact at the State level. The chart shows that in 23 States out of 50 in 1960—or almost half—the average savings and loan was larger than the average commercial bank. I am certain that, by now, in a majority of States, the average savings and loan is larger than the average commercial bank.

From the standpoint of Federal income tax, the tabulation shows that in some States the savings and loans paid no Federal income tax whatever. This was so in Alaska, Delaware, Hawaii, Idaho, Montana, and Rhode Island.

All loan associations paid total Federal income tax of $1,000 or less in Alabama, Oregon, South Dakota, and Vermont.

The average savings and loan in Iowa paid a Federal income tax of only $25 and it was almost twice the size of the average bank; in Missouri it paid $80 and it was about one-third larger than the average bank; in Mississippi it paid a Federal tax bill—in total—of $118 and it was also larger than the average bank; in Connecticut, $150, and in New Jersey, $70.

Closer to the immediate experience of all of you, the 24 loan associations and their many branches here in the District of Columbia at the end of 1960 had resources totaling $1.25 billion, had an average size of $52 million, and yet paid not 1 single cent in Federal income tax.

How has this tax exemption of the mutuals affected their growth at the community level? The answer is that it has enabled them to maintain a rate of growth many times that of banks in the same community.

The attached tabulation designated "Appendix B" contains a list of savings and loan associations and commercial banks and their assets in various communities in both 1954 and 1959. In most cases, the assets of these competing institutions were very similar in 1954. I might say that was the principal area of selectivity in choosing these institutions at random from the services, to select institutions which were of approximately the same size in 1954 and then compare them with the most recent figures and see how this came out.

By 1959, however, the similarity no longer existed; the assets of the loan associations far outdistanced their taxpaying commercial bank competitors.

Senator BENNETT. Is that true for all of them as well as for the average? Were there any that dropped behind?

Mr. ZAUN. We know of none.

Mr. LAGOMARCINO. I put the appendix in, and I know of none where that is true.

Senator WILLIAMS. When you speak of the assets of these associations, are you speaking of the deposits or of the net worth, book value?

Mr. ALBIG. Both, total assets.

Senator WILLIAMS. There is a difference.

Mr. ALBIG. Total assets in banks, total assets of the savings and loan associations.

Senator WILLIAMS. Yes. But are you referring to the total assets as representing the amount on hand in deposits, including that?

Mr. ALBIG. In the case of the banks, the amount of deposits plus the capital.

Senator WILLIAMS. Yes.

Mr. ALBIG. In the case of savings and loans, the amounts of their share accounts plus their reserve accounts.

Senator WILLIAMS. If you subtract the deposits and take the net of each, how would they compare?

Mr. ALBIG. I have not tried that calculation, so I do not know.

The CHAIRMAN. I would like to ask, have you got a table which shows the comparison with the taxes as compared to what the House bill had on the building and loans? These figures you have given do not compare with the House bill, which is—do they or do they not? The House bill increased the building and loan tax, did it not? The figures you give, are they on a basis of the past or are they——

Mr. ALBIG. These are on the basis of the past, Mr. Chairman.

The CHAIRMAN. Have you got a table comparing it to the House bill?

Mr. ALBIG. Have we worked a table comparing it to the House bill? No, sir.

Mr. LAGOMARCINO. These are historical data based on the asset growths from 1954 to 1959, and what we have attempted to show were situations where you had a savings and loan association and a commercial bank of roughly comparable size in 1954 and then we have attempted to show what has happened under 5 years of virtual tax exemption on the part of the savings and loan associations.

The CHAIRMAN. I just wondered if you had a figure here, a table here, showing the tax on banks as compared to the House bill on building and loans.

Mr. ALBIG. No, sir.

The CHAIRMAN. You have not got it?

Mr. ALBIG. No, sir; we have not.

Senator BENNETT. May I, just at this point, Mr. Albig, inquire, in your testimony I think you made a statement that is an inadvertence, and I do not think you would want it to stand.

You said that from 1951 to 1960 the commercial banks paid tax at the rate of 40.8 percent.

Mr. ALBIG. Of taxable income.

Senator BENNETT. Taxable income.

Mr. ALBIG. Yes, sir.

Senator BENNETT. Don't you mean their total income?

Mr. ZAUN. No; net taxable income, sir.

Senator BENNETT. That is the net taxable income.

Mr. ZAUN. Yes, sir. That is the tax rate as applied to the net taxable income.

Senator BENNETT. OK.

Senator CURTIS. What rate is that of the net income?

Mr. ZAUN. Senator Curtis, would you give me that question again? Did you relate it to gross income?

Senator CURTIS. No. I think my term which I want is total net income as contrasted to taxable income, I mean the income after all expenses are deducted, but not the deduction of any tax exemptions.

Mr. ZAUN. The figure you are trying to get at would be the figure we used as net income plus tax-exempt income which would be municipal bonds. I think the figure that you are asking about would be the equivalent of that figure. We do not have that in our calculations. However, it would not be difficult to get it.

Senator CURTIS. You can supply it at a later time.

Mr. ZAUN. Yes; we could indeed.

It would include capital gains income, yes.

(The information referred to follows:)

Earnings, expenses and Federal income tax, paid by insured commercial banks in the United States in 1960

[In thousands of dollars]

Item	Amount
1. Current operating earnings, total	10,723,545
2. Current operating expenses, total	6,932,820
3. Net current operating earnings	3,790,725
4. Recoveries, transfers from reserve accounts, profits	574,826
Total	4,365,551
5. Losses, chargeoffs and transfers to reserve accounts	978,422
6. Net profits before income taxes	3,387,129
7. Federal income tax paid	1,300,910
Federal income tax paid as a percentage of net profits before taxes (7÷6)	38.4

Senator WILLIAMS. This 40 percent which you figure as the tax rate on your taxable income, is that arrived at by an averaging process of what portion of your income would be in capital gains and the rest in 52 percent?

This 40 percent was arrived at as an averaging process, is that correct?

Mr. ZAUN. That is correct. It is an average of all of the States that are here shown. It is the national average.

Senator WILLIAMS. I think the question they were trying to establish is how you arrived at this 40 percent, when there is no such figure in the rate. It is an averaging of the 25-percent capital gains and 52 percent of the other, and enforcing the manner in which you pay it.

Senator BENNETT. Plus an averaging of those banks which earned only enough money to be in the 25- or 30-percent bracket.

Mr. ZAUN. Yes. Actually we did not average rate. We applied to get the 40.8, we applied the dollars paid to the amount of net operating income, which arrives at that percentage figure.

Senator WILLIAMS. You mean your net taxable income.

Mr. ZAUN. Yes, sir.

Now, that would, of course, include the capital gains.

Senator WILLIAMS. That would include your capital gains and a portion of which you paid a 52-percent rate or a 30-percent rate if it is in a smaller institution.

Mr. ZAUN. Yes, sir.

Senator WILLIAMS. One other question while we are at it.

Do you have the figures here which would show the comparison of the assets with your institutions on a net worth basis, or would they be available, after the deposits are checked off as against your liabilities?

Mr. ZAUN. We can furnish those.

Mr. ALBIG. We can furnish those.

Senator WILLIAMS. I wish you would. You can furnish it later, just go ahead.

(The information referred to follows:)

Comparison of capital accounts of all commercial banks and general and unallocated reserves of all savings and loan associations for the years 1955–60

[Dollars in millions]

	1955	1956	1957	1958	1959	1960	1955–60 percentage increase
Commercial bank capital accounts [1]	$15,300	$16,302	$17,368	$18,486	$19,556	$20,986	37.2
Savings and loan general and unallocated reserves [2]	2,557	2,950	3,303	3,845	4,387	4,982	[3] 94.8

[1] Source: Federal Reserve bulletins.
[2] Source: U.S. Savings and Loan League facts books.
[3] This percentage would be substantially higher, except for the fact that the savings and loan associations allocated 29.8 percent of net income to reserves in 1955, but in the years following allocated decreasing percentages, so that only 23.4 percent of net income was allocated to reserves in 1960.

Mr. ALBIG. May I proceed?

Senator WILLIAMS. Yes.

Mr. ALBIG. I would point out on appendix B, gentlemen, if I may digress from the testimony for a second, to indicate a few of these examples, I will not undertake to read all of them, you may pick any of them at random that you would like, but take No. 3, Guardian Savings & Loan Association in Denver was in 1954 a $16 million institution. In 1959 it had grown to $44 million, a growth rate of 174 percent. The Colorado State Bank in the same city, a

$15 million institution, by 1959 had grown to $18 million, a growth rate of 20 percent.

I will not read more of these. They all reflect the same kind of comparative growth pattern.

These examples are not unique nor are they isolated ones. The examples were picked at random, but they are representative of the situation throughout the entire country.

In the case of the smaller community bank or the country bank, the mutual institution which competes with it is usually not even located in the town or village where the bank is located. The competition is nonetheless just as real; the dollar still leaves the community. By means of save-by-mail plans, giveaway advertising campaigns, and account brokers, mutuals in large cities are able to compete for and to draw savings deposits from small communities hundreds of miles away.

These savings deposits are of vital importance to the entire commercial banking system, and particularly to the smaller community bank. On December 31, 1960, time deposits constituted 32.0 percent of all deposits in all insured commercial banks and 38.5 percent in insured commercial banks with deposits of under $10 million. The savings deposit is, therefore, particularly important to the smaller commercial banks with assets under $10 million, which constitute 82 percent of all commercial banks in the Nation. In the country banks with assets of only $1 or $2 million, this percentage is frequently much higher than the 38.5-percent average.

Since the nonmetropolitan banks rely more heavily upon savings deposits for their lending and investment activities than do the metropolitan banks, the loss of these deposits is especially injurious to them. When the community banker does not have savings deposits, his ability to serve the many and varied credit needs of his community is impaired. If you do not have the funds, you cannot make loans.

The community bank operating outside the metropolitan centers is very likely to have in its note case more loans which are made in the starting of a business, or to expand, or to add machinery, or perhaps fixtures, or a new building, as well as those for working capital purposes. The banker makes such loans from available savings deposits which because of their stability traditionally encourage this type of loan.

The virtual tax exemption accorded the mutual institutions not only limits the ability of the banker to serve the community, but it also impedes balanced economic growth. Our citizens have the right to expect that we will serve all their economic needs: a home mortgage, home improvement loan, commercial loan, consumer loan or other installment loan, term loan to a smaller business, construction loan, automobile loan or, in fact, any type of loan which the people and the community need. It is our job and our duty to be a source of credit for every person and for every aspect of community life.

However, in order to promote vigorous growth in every area of the community's economy, the banks must obtain sufficient funds to be able to channel credit into those areas which need it the most at the particular time.

This can be assured only when competition for savings money is on a more equitable basis.

CONCLUSION

In considering the question of an appropriate bad debt reserve for mutual savings banks and savings and loan associations, sight is too often lost of one very important factor, and I direct your attention to it. It is this: operating under the umbrella of the existing 12-percent formula, these institutions over the last 10 years have been able to accrue vast dollar reserves bearing no relation whatever to their actual loss experience, which, in fact, has been negligible.

The competitive importance of these reserves to the loan associations has been made clear in the remarks of Dr. Husband, General Manager of the Federal Savings and Loan Insurance Corporation:

> Everybody believes in having a healthy reserve position, but all too often something seems to stand in the way. Either the reserves are used to absorb losses or real estate sold or rapid growth makes the goal difficult to achieve. Admitting the influence of both these factors, it may be said in all frankness that the rate of dividends paid on savings is probably the chief barrier. Proud of their tradition of paying a higher rate, many savings and loan associations have held fast to the practice.
>
> Analyzing the value of a strong reserve position, there is a tendency to recognize its use only for purposes of absorbing losses. Without minimizing in any way the importance of this particular benefit, there is need to recognize the carrying power which large reserves give to current operations. Providing a source of free capital, reserves may well be a factor of great marginal significance in the competitive struggle which is now going on and which will intensify in the days ahead. There are institutions today whose reserves earn enough to pay all operating expenses—a comforting advantage of no means proportion. (Federal Home Loan Bank Board Digest, January 1961, p. 6.)

At the present time these reserves bear no relation to the loss experience of the mutual institutions. According to the Treasury Department Report of July 1961 the reserves of the mutual savings banks are 24 percent of uninsured loans and the reserves of the savings and loan associations are 9.4 percent of their uninsured loans. By way of comparison, the average commercial bank is allowed a bad debt reserve of approximately 2.4 percent of uninsured loans.

I have said the losses of savings of savings and loan associations are negligible and I base this on the testimony of E. Norman Strunk, executive vice president of the U.S. Savings & Loan League, in the hearings before the Treasury Department's Inter-Agency Committee in May 1961. Mr. Strunk testified that losses have been "very nominal in the last 20 years" and also there have been "virtually no losses in the last 15 years." At another point, it was stated that there has been "an unusually long period of low real estate foreclosure experience."

In the light of these statements, what possible justification exists for exempting 60 percent of the income of the loan associations from income tax?

We can find no reason based in experience—and we seriously doubt if anyone can—for permitting the savings banks and savings and loan associations to be taxed as if they earned a dollar containing less than 100 cents, when no other financial institution, no business, and no person is accorded any such tax bonanza.

What is so unique about these institutions that everyone else in the country, down to the smallest wage earner, should have to pay more tax than he otherwise would, because this great $125 billion industry resists as strenuously as it possibly can the payment of its proportionate share of the national tax bill.

These institutions should be given an annual deduction for a bad debt reserve based upon their actual loss experience. But, there is no justification whatever for the unfair tax preference shown in H.R. 10650.

(The appendixes referred to follow:)

APPENDIX A

THE INDEPENDENT BANKERS ASSOCIATION

77 TIMES MORE TAX IS PAID BY BANKS

1960 - COMPARISON OF OPERATING RESULTS OF COMMER

COMMERCIAL BANKS[1]

(In thousands of dollars)
(Detail will not necessarily add to TOTALS because of rounding)

	No. of Banks	Total Resources	Average Size	Resource Growth '60-'59	Gross Operating Income	Gross Inc. as a % Before Resources	Net Income Before Taxes	Federal Taxes	% of Taxes to Net Inc.	Dividends Paid
Alabama	238	2,259,547	9,494	4.5%	101,533	4.5%	33,080	10,556	31.9%	5,903
Alaska	9	187,665	20,852	10.6%	10,782	5.7%	2,418	918	38.0%	427
Arizona	9	1,332,087	148,010	11.1%	72,050	5.4%	22,212	9,746	43.9%	5,018
Arkansas	232	1,351,476	5,825	5.3%	55,864	4.1%	15,745	4,220	26.8%	4,226
California	112	26,158,878	233,561	3.4%	1,252,373	4.8%	348,737	137,082	39.3%	96,879
Colorado	162	2,112,903	13,043	3.9%	98,967	4.7%	31,393	11,587	36.9%	6,301
Connecticut	61	2,579,035	42,279	3.4%	125,249	4.9%	31,577	10,942	34.7%	8,273
Delaware	19	776,531	40,870	8.8%	36,154	4.7%	16,728	7,791	46.6%	4,730
D. of Columbia	12	1,636,204	136,350	0.9%	67,791	4.1%	21,929	10,662	48.6%	5,579
Florida	304	5,220,379	17,172	3.6%	230,537	4.4%	58,660	21,663	36.9%	11,278
Georgia	363	3,180,466	8,762	5.2%	157,552	5.0%	50,848	19,783	38.9%	11,320
Hawaii	7	722,401	103,200	93.8%	34,587	4.8%	10,529	4,419	42.0%	2,127
Idaho	32	694,532	21,704	2.0%	33,644	4.8%	12,779	3,887	30.4%	2,331
Illinois	960	18,768,382	19,550	3.1%	752,475	4.0%	247,049	94,727	38.3%	47,482
Indiana	437	5,104,475	11,681	3.8%	212,597	4.2%	60,588	24,155	39.9%	11,831
Iowa	635	3,295,549	5,190	0.4%	141,696	4.3%	41,931	12,118	28.9%	9,174
Kansas	583	2,525,097	4,331	3.9%	105,146	4.2%	33,923	10,223	30.1%	6,648
Kentucky	345	2,473,766	7,170	2.1%	101,178	4.1%	40,129	14,881	37.1%	7,244
Louisiana	189	3,168,103	16,762	2.6%	129,275	4.1%	35,931	13,083	36.4%	6,607
Maine	42	695,761	16,566	4.6%	34,021	4.9%	7,843	3,105	39.6%	2,269
Maryland	132	2,486,788	18,839	4.3%	104,748	4.2%	29,331	12,135	41.4%	7,326
Massachusetts	166	5,975,206	35,995	4.0%	286,102	4.8%	111,436	45,740	41.0%	26,686
Michigan	378	9,430,437	24,948	4.4%	414,892	4.4%	106,741	36,269	34.0%	26,737
Minnesota	679	4,520,389	6,657	2.4%	209,596	4.6%	60,746	20,933	34.5%	13,506
Mississippi	191	1,427,395	7,473	5.4%	63,459	4.4%	14,406	4,322	30.0%	4,040
Missouri	610	6,528,368	10,702	2.5%	254,536	3.9%	95,490	40,252	42.2%	19,351
Montana	119	873,883	7,344	1.4%	41,265	4.7%	13,774	4,198	30.5%	2,922
Nebraska	392	1,753,492	4,473	0.7%	74,071	4.2%	24,538	8,526	34.7%	5,524
Nevada	7	462,201	66,029	9.1%	23,854	5.2%	8,082	3,455	42.7%	2,203
New Hampshire	70	448,257	6,404	9.3%	20,986	4.7%	5,410	1,422	26.3%	1,158
New Jersey	250	7,709,435	30,838	4.8%	330,863	4.3%	69,769	19,736	28.3%	21,141
New Mexico	55	749,138	13,621	3.5%	35,103	4.7%	10,121	4,007	39.6%	1,970
New York	390	48,971,695	125,568	4.4%	2,029,303	4.1%	787,245	318,894	40.5%	211,786
No. Carolina	182	3,098,170	17,023	4.6%	140,197	4.5%	41,261	15,711	38.1%	9,137
No. Dakota	153	702,419	4,591	0.5%	33,723	4.8%	10,522	3,296	31.3%	2,599
Ohio	584	12,279,262	21,026	4.2%	518,154	4.2%	166,520	69,792	41.9%	32,718
Oklahoma	386	2,867,449	7,429	4.0%	120,001	4.2%	40,455	14,827	36.7%	8,168
Oregon	49	2,184,813	44,588	1.8%	99,761	4.6%	29,446	11,013	37.4%	6,479
Pennsylvania	691	15,755,784	22,801	3.2%	694,521	4.4%	194,340	71,880	37.0%	64,754
Rhode Island	8	962,023	120,253	4.0%	48,349	5.0%	12,153	4,992	41.1%	4,379
So. Carolina	139	1,105,826	7,956	4.4%	51,053	4.6%	16,246	5,788	35.6%	3,647
So. Dakota	174	794,517	4,566	1.1%	38,049	4.8%	11,561	3,794	32.8%	2,375
Tennessee	291	3,503,700	12,040	4.6%	148,571	4.2%	46,917	18,929	40.3%	9,419
Texas	990	12,806,270	12,936	3.4%	516,781	4.0%	157,206	61,411	39.1%	42,650
Utah	46	1,047,927	22,781	5.0%	49,645	4.7%	18,860	7,444	39.5%	4,207
Vermont	55	440,303	8,006	3.4%	21,259	4.8%	4,202	1,097	26.1%	1,149
Virginia	305	3,537,536	11,598	3.0%	161,746	4.6%	47,909	19,343	40.4%	11,321
Washington	85	2,978,652	35,043	2.3%	143,136	4.8%	44,159	20,081	45.5%	9,368
West Virginia	181	1,410,661	7,794	3.1%	59,121	4.2%	20,087	8,042	40.0%	4,114
Wisconsin	554	4,893,264	8,833	4.0%	195,439	4.0%	53,071	15,240	28.7%	12,554
Wyoming	55	440,911	8,017	3.0%	19,599	4.4%	6,304	2,331	37.0%	1,278
United States	13,118	246,389,408	18,783	3.9%	[illegible]	4.3%	3,382,357	1,300,451	[illegible]	[illegible]

1 Insured commercial banks having 97% of resources of all commercial banks.

Compiled by Committee on Savings & Loan Associations; Independent Bankers Association. Ralph L. Zaun, Chairman.

CIAL BANKS AND SAVINGS AND LOAN ASSOCIATIONS - 1960

SAVINGS AND LOAN ASSOCIATIONS

Total Resources	Average Size	Resource Growth '60-'59	Gross Operating Income	Gross Inc. as a % Before Resources	Net Income Before Taxes	Federal Taxes	% of Taxes to Net Inc.	Dividends Paid	No. of S&L Assoc.	
465,451	11,352	15.6%	25,524	5.5%	19,456	1	0.005%	15,169	41	Alabama
14,423	4,808	19.2%	911	6.3%	578	None	None	399	3	Alaska
282,369	31,374	16.9%	16,379	5.8%	10,866	6	0.06%	8,175	9	Arizona
312,850	6,257	16.3%	15,619	5.0%	12,443	19	0.15%	9,995	50	Arkansas
10,752,230	44,067	18.3%	641,420	6.0%	488,704	1,044	0.21%	364,928	244	California
838,728	16,129	14.7%	45,837	5.5%	34,360	54	0.16%	27,332	52	Colorado
700,289	17,507	9.2%	33,589	4.8%	23,619	6	0.03%	19,647	40	Connecticut
31,841	3,980	7.4%	1,592	5.0%	1,221	None	None	927	8	Delaware
1,257,127	52,380	10.9%	62,308	5.0%	47,597	None	None	39,965	24	D. of Columbia
3,231,494	29,113	14.5%	177,711	5.5%	137,218	21	0.02%	103,292	111	Florida
1,077,583	11,587	10.8%	57,832	5.4%	44,050	43	0.10%	34,772	93	Georgia
136,064	19,438	17.5%	8,065	5.9%	5,928	None	None	3,934	7	Hawaii
160,266	17,807	8.7%	8,199	5.1%	6,577	None	None	5,196	9	Idaho
6,678,968	14,363	11.2%	341,278	5.1%	252,130	134	0.53%	205,725	465	Illinois
1,799,755	10,525	11.3%	91,399	5.1%	67,670	136	0.20%	56,302	171	Indiana
777,884	9,724	14.1%	37,842	4.9%	29,484	2	0.007%	24,444	80	Iowa
826,144	8,606	13.6%	41,769	5.1%	32,314	71	0.22%	25,837	96	Kansas
804,260	9,139	14.2%	40,751	5.1%	32,355	38	0.12%	27,215	88	Kentucky
942,500	10,959	10.3%	49,550	5.3%	39,511	148	0.37%	30,949	86	Louisiana
101,183	4,047	12.0%	4,839	4.8%	3,582	87	2.43%	3,036	25	Maine
1,308,052	15,210	5.6%	65,992	5.0%	50,967	35	0.07%	41,691	86	Maryland
2,004,782	11,588	6.5%	90,836	4.5%	69,978	101	0.14%	58,337	173	Massachusetts
1,841,572	27,082	12.5%	92,285	5.0%	69,061	24	0.03%	53,097	68	Michigan
1,483,759	24,729	12.3%	73,867	5.0%	59,618	55	0.09%	48,514	60	Minnesota
282,257	8,302	13.4%	14,447	5.1%	11,803	4	0.03%	9,246	34	Mississippi
1,750,922	13,896	12.8%	91,705	5.2%	70,107	10	0.01%	55,939	126	Missouri
125,872	8,991	6.7%	6,340	5.0%	4,892	None	None	3,826	14	Montana
394,823	10,390	18.4%	18,673	4.7%	14,755	18	0.12%	12,362	38	Nebraska
53,667	13,417	15.7%	3,143	5.9%	2,482	49	1.97%	1,677	4	Nevada
160,743	7,654	10.8%	7,730	4.8%	5,811	3	0.05%	4,792	21	New Hampshire
2,686,745	11,385	11.5%	127,430	4.7%	100,081	16	0.02%	79,854	236	New Jersey
172,987	8,237	14.3%	9,046	5.2%	7,171	3	0.04%	5,853	21	New Mexico
4,754,306	22,748	11.4%	225,525	4.7%	171,228	241	0.14%	138,276	209	New York
1,349,061	8,328	14.7%	68,260	5.1%	53,844	55	0.10%	43,172	162	No. Carolina
196,745	16,395	14.7%	9,836	5.0%	6,950	2	0.03%	5,756	12	North Dakota
6,146,774	13,276	9.6%	316,034	5.1%	236,600	955	0.40%	194,220	463	Ohio
721,151	13,355	12.5%	36,930	5.1%	28,850	10	0.03%	23,526	54	Oklahoma
466,004	17,923	16.3%	24,617	5.3%	17,280	*	None	14,129	26	Oregon
3,530,818	7,418	11.2%	173,148	4.9%	131,649	129	0.10%	105,571	476	Pennsylvania
264,751	29,417	7.1%	12,367	4.7%	9,070	None	None	7,929	9	Rhode Island
638,630	9,123	11.4%	32,361	5.1%	25,139	86	0.34%	20,456	70	So. Carolina
82,653	6,358	15.0%	4,037	4.9%	3,151	1	0.03%	2,504	13	South Dakota
743,103	14,021	15.5%	38,034	5.1%	29,484	6	0.02%	23,991	53	Tennessee
2,508,872	10,768	17.0	129,365	5.2%	100,683	380	0.38%	80,838	233	Texas
334,672	22,311	10.0%	18,833	5.6%	12,863	71	0.55%	9,870	15	Utah
44,458	5,557	4.2%	2,152	4.8%	1,587	1	0.06%	1,302	8	Vermont
685,409	12,693	16.5%	34,277	5.0%	26,333	29	0.11%	21,782	54	Virginia
1,275,956	20,580	10.7%	65,297	5.1%	49,892	21	0.04%	41,385	62	Washington
219,173	7,306	16.7%	11,226	5.1%	8,577	29	0.34%	6,806	30	West Virginia
1,749,263	12,148	9.3%	87,017	5.0%	71,616	11	0.02%	54,848	144	Wisconsin
77,018	7,702	16.2%	3,764	4.9%	3,028	6	0.20%	2,392	10	Wyoming
[illegible]9,246,402	11,777	12.7%	3,596,988	5.2%	2,743,910	4,161	0.15%	2,181,18[illegible]	4,68[illegible]	United States

1 Members of Home Loan Bank System having 97% of resources of all Federal and State Savings and Loan Associations.

* Less than $500.

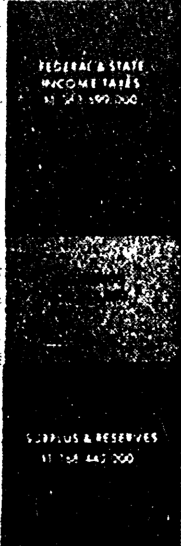
A GRAPHIC PICTURE

Operating results of Insured Commercial Banks compared to the combined operating results of Savings and Loan Associations and Insured Mutual Savings Banks during 1960.

Insured Commercial Banks paid 77 TIMES the income Taxes paid by Savings and Loan Associations and Insured Mutual Savings Banks.

Commercial Banks

NET INCOME
$3,382,357,000



Savings & Loan Associations
and
Insured Mutual Savings Banks

NET INCOME
$3,980,884,000

APPENDIX B

[In millions of dollars]

Institution and city	Assets as of June 30, 1954	Assets as of June 30, 1959	Percent of growth
1. Southern Federal Savings & Loan Association, Pine Bluff, Ark	8.7	19.3	122.0
National Bank of Commerce, Pine Bluff, Ark	17.5	23.1	32.0
2. West Coast Savings & Loan Association, Sacramento, Calif	4.0	30.2	655.0
Merchants National Bank, Sacramento, Calif	19.0	21.3	12.0
3. Colorado Federal Savings & Loan Association, Denver, Colo., and Guardian Savings & Loan Association, Denver, Colo	16.4	44.9	174.0
Colorado State Bank, Denver, Colo	15.0	18.0	20.0
4. Kankakee Federal Savings & Loan Association, Kankakee, Ill	25.0	46.3	85.0
City National Bank, Kankakee, Ill	23.1	25.6	11.0
5. Muncie Federal Savings & Loan Association, Muncie, Ind	18.4	29.5	59.8
Merchants Trust Co., Muncie, Ind	16.9	20.0	18.2
6. Perpetual Savings & Loan Association, Cedar Rapids, Iowa	10.6	20.0	89.0
Guaranty Bank & Trust Co., Cedar Rapids, Iowa	12.8	13.7	7.0
7. First Federal Savings & Loan Association of Lexington, Ky	6.9	14.5	110.0
Lexington Federal Savings & Loan Association, Lexington, Ky	6.8	14.0	106.0
Central Bank of Lexington, Ky	6.7	9.4	43.0
Second National Bank & Trust Co. of Lexington, Ky	8.8	12.0	36.0
8. First Federal Savings & Loan Association of Frankfort, Ky	3.2	7.3	128.0
State National Bank of Frankfort, Ky	5.2	7.3	40.0
9. Lafayette Building Association, Lafayette, La	10.7	27.9	161.5
Home Building & Loan Association, Lafayette, La	7.0	21.4	204.2
First National Bank of Lafayette, La	23.3	31.0	32.7
10. Ben Franklin Federal Savings & Loan Association, St. Paul, Minn	10.7	22.6	110.5
Northern Federal Savings & Loan Association, St. Paul, Minn	12.1	26.5	119.4
Commercial State Bank, St. Paul, Minn	16.4	20.4	24.3
First Grand Avenue State Bank, St. Paul, Minn	7.9	11.6	45.6
11. Occidental Building & Loan Association, Omaha, Nebr	9.6	16.0	67.0
Commercial Savings & Loan Association, Omaha, Nebr	18.3	54.3	196.4
North Side Bank, Omaha, Nebr	9.9	13.1	32.5
Packers National Bank, Omaha, Nebr	11.5	15.7	37.1
12. Chaves County Savings & Loan Association, Roswell, N. Mex	3.6	6.3	74.6
Roswell State Bank, Roswell, N. Mex	6.2	10.1	61.3
First National Bank, Roswell, N. Mex	26.6	27.9	5.4
13. First Federal Savings & Loan Association and Hancock Savings & Loan Co., Findlay, Ohio	10.5	15.8	50.0
Ohio Bank and Savings Co., Findlay, Ohio	10.4	13.3	28.0
14. Pioneer Federal Savings & Loan Association, Baker, Oreg	2.2	5.4	145.0
First Federal Savings & Loan Association, The Dalles, Oreg	1.3	2.1	62.0
Valley National Bank, Milton-Freewater, Oreg	2.6	2.9	12.0
15. First Federal Savings & Loan Association and Williamsport Federal Savings & Loan Association, Williamsport, Pa	4.8	9.3	94.0
Savings Institution of Williamsport, Williamsport, Pa	4.2	4.45	6.0
16. Home Federal Savings & Loan Association, Knoxville, Tenn	31.1	63.0	103.0
Bank of Knoxville, and Tennessee Valley Bank, Knoxville, Tenn	30.6	38.6	26.0
17. Ogden Federal Building & Loan Association, Ogden, Utah	10.1	20.5	102.2
Ogden First Federal Savings & Loan Association, Ogden, Utah	8.4	15.1	79.7
Bank of Utah, Ogden, Utah	7.2	12.2	68.8
Commercial Security Bank, Ogden, Utah	29.6	42.1	42.4
18. First Federal Savings & Loan Association, Madison, Wis	5.9	11.5	95.0
Madison Bank & Trust Co., Madison, Wis	6.2	10.7	72.0
19. Oshkosh Savings & Loan Association, Oshkosh, Wis	10.9	23.7	117.0
Oshkosh National Bank, Oshkosh, Wis	10.7	12.4	16.0

Mr. ALBIG. Mr. Chairman, with your permission, I would like to insert into the record our rebuttal testimony before the Inter-Agency Committee inasmuch as I do not believe it will be in the record of the House proceedings on this, and also a letter dated August 19, 1961.

directed to Chairman Mills of the Committee on Ways and Means, following the hearings before the Ways and Means Committee.

The CHAIRMAN. Without objection, the insertion will be made.

(The documents referred to follow:)

INDEPENDENT BANKERS ASSOCIATION

REBUTTAL TO REMARKS OF THE SAVINGS AND LOAN ASSOCIATIONS AND MUTUAL SAVINGS BANKS BEFORE THE INTER-AGENCY COMMITTEE

A. THE MUTUAL INSTITUTIONS DID NOT PROVIDE THE CANDID TYPE OF TESTIMONY DEMANDED IN HEARINGS OF THIS NATURE

A reading of the transcript of the presentation of the mutual institutions before the Inter-Agency Committee shows that a true rebuttal on the facts has been made virtually impossible. The presentation was characterized by a complete failure to supply concrete facts in those areas where the mutuals should have the facts and where the facts would be of vital importance to the establishment of an appropriate tax formula. The hearings were also marked by a failure to supply any information upon the effects of the Harrison-Curtis bills on these operations or to consider any alternatives to them. The transcript does not show the candid and open type of testimony the Treasury has a right to expect in proceedings called to assist in preparing important legislation.

Thus, the transcript shows that in connection with the question of the probable percentage of bad debt losses in any future depression, it would "be difficult to estimate that with precision" (196). It was not known "with precision what our loan losses were in the thirties according to the Treasury tax formula" (196). As a matter of fact, no detailed depression-dollar experience of any kind was ever supplied, despite the fact their whole case rests upon building a reserve for some future depression. The mutuals did not think they could make any real estimate "on the possible percentage of loss on FHA-insured or VA-guaranteed loans" (179–180).

As to how much it might be necessary to reduce dividends or interest rates and yet maintain additions to reserves, the transcript shows that this, too, is a "difficult question to answer with any precision" (183). As to the effect of a rate reduction on their deposit and share account growth, "it would be varied" (184). And, despite the fact they resist the Harrison-Curtis bills vigorously, they purport not to know the effect of the bills upon them (212–214).

Moreover, although Assistant Secretary Surrey repeatedly warned that the burden was upon these institutions to establish their right to further tax exemption or to come up with an alternative proposal, no support was given to any measure other than the existing 12-percent reserve provision (200, 201, 211, 214, 218, 227, et al.).

B. THE 12-PERCENT BAD-DEBT RESERVE IS EXCESSIVE, BOTH IN THE LIGHT OF PAST EXPERIENCE AND FOR ANY FUTURE DEPRESSION

The transcript contains no record whatever of the bad-debt dollar loss of the mutuals. According to Mr. Strunk, executive vice president of the U.S. Savings & Loan League: "I don't know where the records would be to permit you to go back and study, because our institutions haven't kept records of that kind that would be needed to make that kind of a determination" (340). This astounding statement must be measured in the light of the fact that loan associations have filed Federal tax returns for almost 10 years, this bad-debt reserve is the one single factor responsible for the virtual tax exemption of these institutions and for their vast growth due to their ability to pay higher rates than oher institutions, and the almost certain knowledge this entire area of tax law must eventually be subject to review by the Treasury Department and the Congress. In the light of these facts, this statement is incredible.

1. There has been virtually no bad-debt losses of mutuals in recent years

Although exact data is not provided, general statements in transcript indicate bad-debt losses of the mutuals have been insignificant for a substantial period of time. Mr. Strunk says losses have been "very nominal in the last 20 years"

(322) and there have been "virtually no losses in the last 15 years" (347). At another point, it is stated that there has been "an unusually long period of low real estate foreclosure experience" (248).

Certainly, this is borne out by facts available elsewhere. In the period 1955–59, inclusive, member savings and loan associations allocated an average of $435 million in tax-free income to reserves; during the same period, the actual charges against these reserves averaged under $4 million per year. This means that their actual loss experience charged against reserves—bad debt and from other sources—was less than 1 percent of the amount allocated.

These reserves under existing law have no relationship to their bad-debt experience. At the present time, the reserves of mutual savings banks are 22 percent of risk assets and, under the 12-percent formula, that reserve can be built to 28½ percent of risk assets. For the savings and loans, the reserves constitute 9 percent of risk assets and can be built as high as 13 percent (25). By way of comparison, the average commercial bank is allowed a bad-debt reserve of approximately 2.4 percent of risk assets.

This difference cannot be justified by the different natures of the two types of institutions. The bad-debt losses of savings and loans, for example, are not completely unrelated to those of commercial banks. According to Mr. Strunk, speaking of the 20-year period upon which commercial banks are permitted to base their bad-debt formula: "Our average annual losses apparently in that period are not much different from commercial banks, as I understand what somebody said the figures are" (321). No such figures have been supplied and, in fact, we are told elsewhere they do not exist.

The transcript does show that the loss experience of both a small commercial bank and one stock savings bank, which performs essentially the same functions as the mutual savings banks, has been virtually nil (62, 65, 109).

2. Depression experience in the 1930's will not support continuance of the 12-percent reserve provision

Since there is no basis whatever in the actual loss experience of the mutuals going back over a period of 20 or 25 years to justify the vast amount of reserves they have built up, the mutuals base their argument largely on depression experience in the early 1930's.

The savings and loan associations attempt to justify a 12-percent bad-debt reserve largely upon a study of the loss experience of mutual savings banks in Massachusetts between 1930 and 1945. This study was made by Professor Lintner of Harvard University and the results of it appear in his book, "Mutual Savings Banks in the Savings and Mortgage Markets" (1948). Professor Lintner reported a 17.4-percent loss on average mortgage portfolio by those Massachusetts institutions in those years.

This loss figure does not support the present 12-percent reserve provision. The 17.4-percent loss figure is an aggregate loss figure for the full 15-year period involved. On an annual basis, the loss rate would be 1.16 percent.

Moreover, Professor Lintner's recommendation of a maximum mortgage evaluation reserve was:

"* * * the maximum mortgage evaluation reserve which would be required over another depression might be on the order of 5 percent to 8 percent of outstanding uninsured portfolios" (at p. 311).

It is important to recognize also that this recommended reserve is based on uninsured portfolios. It is also important to compare this data with commercial banks loss experience of approximately 15 percent during only 3 years of the depression period, according to Mr. Greensides of the FDIC (297).

If depression experience of the 1930's was a completely valid comparison, it would show injury to all segments of the banking business. Economic injury is not limited to one type of institution or to one type of loan. If the 2.4-percent reserve of risk assets of commercial banks today is adequate to see them through any period of financial depression, why are the mutual institutions so different that they need a reserve on risk assets of between four and nine times greater. A depression is not that selective.

3. The economic setting today provides more safeguards against depression than that which preceded the depression of the 1930's

The depression experience is not a sound measure of any future depression experience, because the facts today are just not comparable to those of the

1930's. Moreover safeguards exist today, which did not exist in the 1930's, to soften the impact of any future depression.

(1) FHA-insured and VA-guaranteed mortgages.

(2) Mortgage protection insurance.

(3) Amortization mortgages.

(4) Bank deposits and loan association share accounts not frozen because of Federal deposit insurance and Federal savings and loan insurance.

(5) Unemployment compensation.

(6) The Government will participate actively to prime the economy and provide welfare in a manner not even contemplated 30 years ago.

(7) Bank assets are not as committed to loans in connection with stock market speculation. According to the Schweiger & McGee study, "Chicago Banking" (1961) : "By 1929, many of these banks [in Illinois] were heavily involved in the stock market speculation of the time. As of June 1929, State-chartered commercial banks in Illinois, as a group, had more than 30 percent of assets in loans with securities as collateral. As a group, national banks in Illinois were somewhat more restrained with only 20 percent of assets of this type of loan."

In contrast, at the end of March 1961, loans to New York Stock Exchange firms secured by other than U.S. Government obligations totaled $3.6 billion and loans to brokers and dealers on the same security totaled $1.9 billion, or a total of $5.5 billion against total commercial bank assets of $246 billion.

(8) Bank regulation is more effective. "The banking collapse in the early 1930's again was in large part the result of insufficient regulation and control of banks." (Kent, "Money and Banking" (1947)), quoted in Senate Report 196, 86th Congress, 1st session. Banks cannot be said to be underregulated now.

The depression experience of the 1930's not only does not support a 12-percent reserve, but any future losses will not even be as large due to the various safeguards existing today.

Moreover, it is worthy of mention that in New York State, where mutual savings banks are strongest, these institutions actually increased their deposits between 1930 and 1935 by 8 percent.

C. THE TAXATION OF THE MUTUALS WOULD NOT PUT A COMPLETE STOP TO THEIR GROWTH

Effective taxation of the mutuals would affect their interest and dividend rate by about one-quarter of 1 percent, and, in return, the Federal Government would receive additional tax revenue of about $300 million per year.

According to their testimony, a one-quarter percent reduction in rate would make it "impossible to maintain the housing and remain solvent." (328) : "under most circumstances, put a complete stop to their growth." (177) : and would almost cause "a crisis in the home mortgage market." (269).

Of course, the one-quarter percent would do none of these. These unsupported statements can be intended only to confuse. At the present time, the transcript shows the spread in interest rates favors the mutuals by about 1½ percent. The average commercial bank rate on time deposits is 2.56 percent and the average rate of the savings and loans is 4.02 percent (288). A reduction of one-quarter percent would still leave a spread of 1¼ percent.

D. A 12-PERCENT RESERVE IS NOT REQUIRED, DUE TO ASSERTED HIGHER PERCENTAGE LOAN PRACTICES

The argument has also been made in transcript that large reserves are necessary because "many of the savings and loans are making loans up to 90 percent of value for 25 years." (298). Despite the assertion, in actual fact, only a very small amount of these loans have been made.

Authority was given Federal savings and loan associations in October 1958 to make conventional home loans in excess of 80 percent of the appraised value of the property. Between October 1958 and the end of June 1960, the total of all these loans amounted to only $146 million.

Moreover, quoting from the report of the Operating Analysis Division of the Federal Home Loan Bank Board:

"When viewed in relation to all new loans granted by these institutions in the first half of 1960, the higher percentage mortgages comprised only 1.5 percent

of the $2.6 billion made for the construction and purchase of new and existing homes."

Furthermore, relevant data fails to disclose any trend toward substantial increases in these types of loans. Such loans totaled only $39.5 million in the first half of 1960, as against $38.6 million in the first half of 1959, or an increase of 2.4 percent. A comparison of the second quarter of 1960 with the second quarter of 1959 shows a decrease in such loans of 5.9 percent.

Accordingly, the impact of these 90-percent loans on the reserves of the loan associations is literally insignificant.

One loan association spokesman also stated: "* * * in the last depression, I can remember the loans that we made which were 10- and 12-year loans and they were for 65 percent of the property. Now the great bulk of our loans are over 75 percent," (345). This experience is atypical. At the end of 1959, according to reports of the Federal Home Loan Bank Board, the ratio of loans to purchase price for all insured savings and loan associations was 66.6 percent.

E. THE MUTUAL INSTITUTIONS PAY A VERY SMALL FRACTION OF THE INCOME TAX PAID BY COMMERCIAL BANKS

In transcript, the mutual revive their "generation" argument, i.e., that they generate more income tax per $1,000 of assets than do commercial banks (298). This argument is an old and weary one, based on a false premise and repudiated many times. Nevertheless, it has to be answered, for otherwise, by repetition alone, it might, in time, gain acceptance.

Since table A, which is referred to on page 249 of the transcript and which contains their computations, has not been made a part of the record, other data will be used for rebuttal. In either event, regardless of the year used, the argument and the rebuttal to it are the same.

How do the mutuals support their argument that they generate more income tax than commercial banks.

(1) Find the Federal income tax paid by the associations and by the commercial banks.

(2) Find the estimated Federal income tax paid by the shareholders of loan associations on dividend payments to them and by time depositors and stockholders on interest and dividends paid by commercial banks, assuming a 20-percent tax bracket in each case.

(3) In each case, total the actual and estimated tax paid (paragraph (1) plus paragraph (2) above) and apply the resulting figure against the assets of the association and of the commercial banks.

Data for 1956, the year ordinarily cited by the associations to support this argument, show that the total of the Federal income taxes paid by the loan associations and the estimated amount paid by their shareholders was $5.02 per $1,000 of assets. The Federal income tax paid by the commercial banks and the estimated amounts paid by their savings depositors and stockholders was $4.87 per $1,000 of assets.

Does this mean that the United States "realizes more income tax" from loan associations than from commercial institutions? No, of course, it doesn't—if total tax dollars is to be the test.

From the standpoint of total tax dollars involved, 1956 data reveals that loan associations actually paid Federal income tax of $5.07 million and insured commercial institutions paid $770 million in that year. If the estimated tax paid by shareholder of loan associations is to be taken into account (and this procedure is not sound in determining the tax paid by an institution itself), it would amount to $201.9 million as against the estimated Federal income tax paid by savings depositors and stockholders of insured commercial institutions of $284.6 million. The total tax paid, both actual and estimated, would be $206.9 million for loan associations and $1,054.6 million for commercial institutions.

The argument cannot be based, therefore, upon a comparison of tax paid directly by the respective types of institutions, or even by comparing the estimated tax dollars paid by depositors and shareholders; it can only be made by totaling actual payment and estimated payment and then relating this total to assets. This type of computation would be relevant if taxes were levied on assets. An income tax, however, is a tax on income, not on assets.

It should be noted that the mutual institutions' formula of relating taxes paid to the assets of the paying institution even fails down if data for the year

1958 is used instead of 1956. In 1958, commercial banks paid $6.82 in Federal income tax per $1,000 of assets and loan associations paid $5.62 per $1,000 of assets. In terms of dollars, the combined actual and estimated income tax paid by loan associations was $299.1 million, whereas commercial institutions would have paid $1.6 billion.

However, all of these considerations are academic; this method of computing tax paid is unsound in the first place. The tax paid by an institution does not include the estimated tax paid by a person on the institution's payments of interest or dividends to him. By this line of reasoning, one could add the tax paid by a second person on payments of that same amount by the first person—ad infinitum—until the tax was several times the amount of original distribution itself.

F. THE TAX-FREE RESERVES OF LOAN ASSOCIATIONS ARE NOT OF GREAT VALUE IN THEIR COMPETITION WITH OTHER INSTITUTIONS

Throughout the transcript, reference is made to the fact that reserves are set aside and serve the sole purpose of providing a cushion against possible losses. At one point, one speaker explains the purpose of this deduction from income in these words: "It is for bad-debt losses, on investment losses, on real estate, and whatever losses you may incur" (301).

However, as the same speaker has candidly stated in remarks to loan associations themselves, elsewhere, "without minimizing in any way the importance of this particular benefit," these reserves are a factor of "great marginal significance in the competitive struggle" because in some institutions these reserves earn enough to pay "all operating expenses."

"Everybody believes in having a healthy reserve position, but all too often something seems to stand in the way. Either the reserves are used to absorb losses on real estate sold or rapid growth makes the goal difficult to achieve. Admitting the influence of both these factors, it may be said in all frankness that the rate of dividends paid on savings is probably the chief barrier. Proud of their tradition of paying a higher rate, many savings and loan associations have held fast to the practice.

"Analyzing the value of a strong reserve position, there is a tendency to recognize its use only for purposes of absorbing losses. Without minimizing in any way the importance of this particular benefit, there is need to recognize the carrying power which large reserve give to current operations. Providing a source of free capital, reserves may well be a factor of great marginal significance in the competitive struggle which is now going on and which will intensify the days ahead. There are institutions today whose reserves earn enough to pay all operating expenses—a comforting advantage of no mean proportion." Federal Home Loan Bank Board Digest (January 1961, p. 6).

G. IN THE COURSE OF THE HEARINGS A NUMBER OF STATEMENTS WERE MADE BY THE MUTUAL INSTITUTIONS WHICH REQUIRE CLARIFICATION

1. It has been suggested that savings and loans may soon reach a tax-paying status. In the period between 1956 and 1959 the reserves of loan associations, as a percentage of savings capital, increased from 7.94 to 8.04 percent, or an average of 0.033 percent per year. At this rate of growth, the 12-percent figure provided in section 593 of the code would not be reached until after well over 100 years, or sometime late in the 21st century.

2. The transcript contains references which are designed to make one conclude that mutual institutions are small institutions serving the small saver. Accordingly, it is stated that half of savings and loan accounts are less than $900 (245).

However, the savings and loan associations and the mutual savings banks are not the savings institutions of the small saver: the commercial bank is. Data for 1959 shows that the average savings account in a commercial bank is $1,000 as against $2,072 in a savings and loan and $1,566 in a mutual savings bank.

The mutual savings banks also refer to the fact that almost half of their banks have assets of less than $20 million. However, in comparison, from the standpoint of deposits, 12,236 commercial banks, or more than 90 percent of the 13,472 commercial banks in the Nation had deposits of less than $20 million at the end of 1960. Moreover, the insert following page 31 of the transcript shows that the average loan association in 1959 was larger than the average

commercial bank in 22 States out of 50. Due to their rapid growth, it seems safe to conclude that the average loan association is larger than the average commercial bank in a majority of States today.

3. It is asserted that the 12-percent reserve is a "ceiling on the bad debt reserve additions of savings banks" (140). The thought that reserves may not be increased under the Harrison-Curtis bills appears through the record. Of course, it is erroneous. As Mr. Surrey remarked: "Well, you are not prevented from accumulating reserves. You are asked to pay a tax on this reserve, which is a different point. * * * From the standpoint of the proponents, the other banks, they are asking that you not stop accumulating, but that you pay tax on it like others" (210).

4. In transcript, reference is made to the study of Professors Schweiger and McGee that:

"Least successful in attracting long-term savings into *local* financial institutions are areas with unit commercial banks, savings and loan associations, credit unions, but no mutual savings banks" (235). [Emphasis added.]

In the sentence following, which was not quoted, the authors indicate that these funds are not lost to the economy, however:

"In these areas, savers put relatively more reserves into other forms of savings, such as postal savings, savings bonds, and cash."

5. The suggestion was made in transcript that the savings deposit business is not profitable to commercial banks. However, several studies of this question have been made, which have indicated that the average return on prudently managed savings dollars has approximated 1 percent. These studies have been made by several organizations. There was the 1957 study of the New York State Bankers Association and the Country Bank Operations Commission of the American Bankers Association. A few years earlier the Kansas Bankers Association undertook a similar study. If you wish to go beyond that, there is the 1951 ABA countrywide survey of over 2,000 smaller banks. That study also showed that the profits ranged from 0.8 percent to 1.5 and averaged 1.1 percent. When we consider that net profit of a commercial bank typically averages less than 1 percent on deposits, we can see that there is little basis for the contention that the savings deposit business is inherently unprofitable.

CONCLUSION

As Mr. Wallace asked at the hearing: "But now, however, you have got billion dollar institutions and a hundred-billion-dollar industry * * * (How) can you justify a special tax treatment for a business enterprise of this size?" (352–353). This is a question that commercial bankers have been asking themselves for years. There is absolutely no justification for the tax discrimination between the commercial banks and the mutual institutions with which they compete.

As mentioned previously, in about half of the States, the savings and loan is larger than the commercial bank (31). It earns more income on its resources (ibid). It is growing faster than the commercial institutions by almost four times (ibid). The commercial banks serve the small savers, because average savings accounts in commercial banks are half those of the savings and loan and two-thirds those of savings banks. Why should these larger, more profitable mutuals serving the larger saver be tax exempt when the smaller commercial banks pay taxes at the full corporate rates? Why, of all the major financial institutions, should the savings and loans and the mutual savings banks be exempt from Federal taxation?

Who can deny that housing is important to the national economy, but it is nonetheless only one sector of that economy. Money is needed to support all the needs of all phases of the economy, not just one alone.

Moreover, although the loan associations speak as if they alone financed housing, in actual fact, the large majority—60 percent of housing itself—is financed by nonsavings and loan institutions, and this does not take into account the amount of money which commercial banks lend on projects incident to the house itself and furnishings and equipment to make it habitable.

As Mr. Freeman pointed out (34), the banks provided $18 billion of loans for schools, streets, sewers, and lighting; $6 billion for home furnishings, home improvement, and modernization; and $5 billion for the construction and real estate industries. Where the need exists, the commercial banking institutions will provide the funds.

To speak of home financing as a matter of "overriding importance" (252) to the economy is to overstate the proposition out of all true proportion. Banks have no "bias against residential mortgages" (274), as charged. Banks do have a bias for supplying the credit needs of the entire economy.

The importance of the time deposit to the commercial bank should not be underestimated. Time deposits are of vital importance to commercial banking institutions, and particularly to the small commercial bank. The transcript states that demand deposits constitute 70 percent of the deposits of commercial banks and that only "30 percent of the money costs the banks either interest to savings depositors or dividends to stockholders" (262).

In actual fact, on June 10, 1959, time deposits constituted 36 percent of all deposits of individuals, partnerships, and corporations in the Nation's 13,097 insured commercial banks. However, on that same date, time deposits constituted 41.5 percent of all these deposits in the 10,687 insured commercial banks with deposits of less than $10 million. On June 15, 1960, time deposits were 47.1 percent of all deposits of individuals, partnerships, and corporations of all commercial banks. Accordingly, at the present time, time deposits and demand deposits in the commercial banking system are of about equal importance to all banks and, it would seem fair to conclude, time deposits more important than demand deposits to the smaller commercial bank. In fact, measuring the relationship of the two types of deposits in insured banks against the latest ratio of these deposits for all banks, time deposits constitute about 55 percent of all deposits of individuals, partnerships and corporations in banks with deposits under $10 million.

Since the smaller, nonmetropolitan banks rely more heavily upon time deposits for their lending and investing activities than metropolitan banks, the loss of their savings deposits to mutual institutions is especially injurious to them.

If the community banker does not have savings deposits, his ability to serve the credit needs of his community will be impaired.

As Mr. Surrey pointed out to the mutual savings banks and loan associations: "* * * you alone, of all mutual institutions, say you are not required to pay taxes" (329). Moreover, again in Mr. Surrey's words, if the 12 percent reserve were continued: "* * * of all the institutions in this country, you would be the only major financial activity free of taxes" (335).

There is no reason whatever for continuing the tax exemption of this hundred-billion-dollar industry. The mutuals should pay taxes just like everybody else.

Respectfully submitted.

REED ALBIG,
President, National Bank of McKeesport, Pa.; President, Independent Bankers Association.

RALPH L. ZAUN,
Executive Vice President, Grafton (Wis.) State Bank; Chairman, Committee on Savings & Loan Associations, Independent Bankers Association.

Of Counsel
PAUL D. LOGAMARCINO,
Attorney, Washington, D.C.; Counsel to Committee on Savings & Loan Associations, Independent Bankers Association.

MAY 26, 1961.

THE INDEPENDENT BANKERS ASSOCIATION,
McKeesport, Pa., August 19, 1961.

Hon. WILBUR D. MILLS,
Chairman of the Committee on Ways and Means,
House of Representatives,
Washington, D.C.

DEAR MR. MILLS: Having had the benefit of listening to the arguments at the hearings on August 9 and 10 and of talking with bankers about the country since, then, and having had some time for reflective consideration, I write this to share with you my thinking about taxing mutual financial institutions.

I suppose it is easy to understand why bankers as lenders are very much concerned about fiscal responsibilitiy. They want to see that tax money is provided to pay currently for increased appropriations for defense. Many people talk with their bankers about the cost of government, and they too expect

that provision will be made to pay the cost. Americans are a responsible people and most bankers share my belief that our citizens manage very capably in planning their affairs.

People do expect that loopholes in the tax laws will be closed before any general increase in tax rates is imposed. Not many people knew about the tax exemption of the mutuals before your committee hearings but now the word is getting around pretty fast. The most often heard reaction is "How come?" Taxpayers expect everyone to carry his share.

The arguments over taxing mutual financial associations and the effects of doing so have been voluminously presented. I will not go all over them again. Three arguments seem to stand out above all the others:

1. If the mutuals deduct all of the cost of the tax from the interest now paid to their customers it would effect a reduction of from ¼ to ½ percent.

Comment: Whether they deduct all of the tax cost from their customers or absorb some or all of it will be a decision largely influenced by competition and their own good business judgment.

2. A reduction of ¼ to ½ percent will cause a slowdown in the flow of money to them.

Comment: Perhaps so, but they will retain a considerable advantage in the spread between the return they pay as compared to bank savings accounts and other forms of savings. We would anticipate that there may be some shifting from savings and loan associations to mutual savings banks because of greater assurance of availability, and we hope there will be some flow into the commercial banks. We in the community banks especially require these deposits in order that we can continue to do the job we are expected to do in providing needed flexibility to serve the financial requirements of the community.

3. The money available for mortgages will dry up.

Comment: Money is and will be available from banks, pension funds, insurance companies, and private citizens. The savings and loans have come into a dmoinant position in the residential mortgage field over the past 10 years because of the amount of their available funds and the resulting urge to find investment combined with broader lending powers. The banks, both commercial and mutual savings banks, have tried to meet this challenge by emphasis on FHA and VA loans which may be made for a higher percentage of appraisal. Insurance companies, too, have made FHA and VA loans. And now, any citizen may become an insured holder of FHA mortgages. To the extent that savings money moves from savings and loans into mutual savings banks and commercial banks it will still be available for mortgages including FHA and VA. I would remind you that there is no statutory limitation on the amount of FHA and VA loans which may be owned by national banks and most State banks as well. Pension funds and private citizens may be reasonably expected to hold mortgages in increasing amounts.

As to the proposed tax, I have these thoughts:

1. It is not difficult of administration as is for example the withholding tax.
2. It will produce substantial revenue.
3. Treasury is well qualified and informed to establish a formula.
4. The contention that large segments of the business community are permitted to compete under the protection of a tax umbrella will be quieted.

We presume to believe that because we represent leadership of a large and important segment of the financial life of our country that you and your colleagues respect our views. We are aware not only of the responsibility which we have been chosen to assume but we regard equally the task and responsibility which is yours. Admittedly, a proponent of this tax proposal, unwelcome as it may be to those affected by it, I have written thus to you from a desire to be helpful in that I can reflect to you what I am hearing, which things I am interpreting within the limits of my capacities.

Warm personal regards.

Sincerely,

REED H. ALBIG, *President.*

The CHAIRMAN. Have you concluded?

Mr. ALBIG. Yes.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. No questions.
The CHAIRMAN. Senator Williams?
Senator Bennett?
Senator BENNETT. I asked my questions.
The CHAIRMAN. Senator Curtis?
Senator CURTIS. I have no questions.
The CHAIRMAN. Thank you very much.
Mr. ALBIG. Thank you, sir.
The CHAIRMAN. The next witness is Mr. Frank P. Lindsey, Jr., on behalf of the Georgia Bankers Association.
Please proceed, Mr. Lindsey.

STATEMENT OF FRANK P. LINDSEY, JR., ON BEHALF OF THE GEORGIA BANKERS ASSOCIATION

Mr. LINDSEY. Mr. Chairman, members of the committee, as the executive vice president of the Georgia Bankers Association, I would like to submit a statement on behalf of the Georgia Bankers Association. The Georgia Bankers Association is composed of 374 member banks. Practically all commercial banks in Georgia are members of this association.

I would like to restrict my remarks to only two sections of the Revenue Act of 1962. The sections to which I refer are section 8 and section 19 of H.R. 10650. The subject matter contained in sections 8 and 19 of H.R. 10650 have both been used as a basis for resolutions adopted by the Georgia Bankers Association in annual conventions in years 1960 and 1961. During each of these years the Georgia Bankers Association has passed resolutions endorsing the principle of tax equality between all financial institutions and on the other hand, the GBA has adopted resolutions in conventions in both those years in opposition to mandatory withholding of taxes on interest and dividends.

Georgia bankers were very much encouraged earlier this year when they learned of the provisions in the proposed tax bill which was considered by the Ways and Means Committee of the House of Representatives. It appeared from the tentative text that tax equality between financial institutions would be incorporated in the revenue measure. We were, therefore, disappointed in the final draft of H.R. 10650 when the provisions which were incorporated in the discussion draft were amended so that mutual thrift institutions will have the opportunity to take a deduction for amounts set aside in a loss reserve on qualifying real property loans based on either of two alternatives. One of these alternatives allows a deduction of 60 percent of taxable income of an institution computed without regard for any loss deduction. In effect this means that the actual tax rate for such mutuals will be 10 to 20 percent whereas commercial banks which are competing with the mutuals for the saver's dollars will be paying an average of over 35 percent.

Commercial bankers in Georgia feel that section 8 of the bill should be amended and strengthened. The provision exempting 60 percent of the net income from tax on the part of mutual thrift institutions is completely unjustifiable and this exemption should be stricken from the bill. Secretary Dillon has stated that this change would yield ad-

ditional millions in taxes each year. Secretary Dillon has also stated that he thought so-called thrift institutions should be made to pay a tax on about 80 percent of the net operating income.

Information from the combined financial statements of the Federal Home Loan Bank Board in 1960 indicates that 19 major savings and loan associations in Atlanta, Ga., having a total net income of $4,743,-000 paid a total Federal income tax of only $20,000. This is an average of $1,053 per institution. From this same source of information, it is indicated that five savings and loan associations in Augusta, Ga., and South Carolina, having a net income in 1960 of $437,000 paid no Federal income tax that year.

Some months ago President Kennedy in a speech to the American people said:

> I am certain that every American wants to pay his fair share (of taxes) and not leave the burden of defending freedom entirely on those who bear arms. For we have mortgaged our very future on this defense—and we cannot fail to meet the payments.

On April 20 last year, President Kennedy said:

> Contrary to the intention of Congress, substantial income from certain cooperative enterprises, reflecting business operations, is not being taxed to the cooperative organization itself or its members. This situation must be corrected in a manner that is fair and just to both the cooperatives and competing businesses.

Members of the Georgia Bankers Association, as evidenced by resolutions of 1960 and 1961, share the President's views in this regard. We feel that competnig financial institutions should be on the same tax basis. We believe that tax laws should be equitable between financial institutions and that if any subsidies are to be granted that they should not be given by the prostitution of the tax law.

The withholding provision of H.R. 10650 which is contained in section 19 of the bill is objected to by members of the Georgia Bankers Association. Members of GBA in annual conventions during 1960 and 1961 passed resolutions in opposition to the requirement that taxes be withheld from dividends and interest. There has been no change in the official position of GBA in this regard.

Members of GBA are unanimous in their belief that everyone should pay his fair share of taxes whether they be individual or corporate. It would be inconsistent for members of GBA to endorse principals of tax equality as contained in this bill and on the other hand be opposed to everyone paying his share of the tax load. We look forward to the time when the budget will be balanced.

We realize that many taxpayers have avoided the payment of income taxes on receipts from dividends and interest. Members of the Georgia Bankers Association and members of the American Bankers Association have cooperated with the Treasury Department for the past several years by enclosing with monthly statements notices calling attention to the taxpayer's responsibility in reporting income from dividends and interest. We believe that this campaign has been beneficial but that it has not been given sufficient time to prove its value.

It is our belief that the provision for withholding taxes under this bill is impractical both from the standpoint of individual banks and taxpayers generally. It is anticipated that if this provision is enacted that there will be many difficulties incurred in the areas of savings accounts, trusts, savings bonds and interest coupons. Due to the

fact that there is no requirement that the payer of interest or dividends notify the recipient of the amount of tax withheld, this in itself means that an unlimited number of errors could occur in reporting amounts withheld. The individual who receives dividends or interest will have to calculate on his own what he believes to be the amount withheld.

The additional work which will be required of banks and other business organizations which pay interest or dividends will be tremendous. It is suggested that if the withholding provision of this bill is retained that some minimum limitations be specified to reduce the number of accounts from which taxes must be withheld on dividends and interest. A large Atlanta bank has stated that of 44,000 savings accounts in that bank that they carefully estimate that 50 percent of the owners of these accounts would not be in a bracket sufficiently high for Federal income tax purposes.

It has been estimated that if withholding were limited to savings accounts paying $48 or more of interest, practically all minor accounts and the majority of accounts held by persons of 65 years and over would be exempt from withholding. By setting the cutoff at $48, this would almost eliminate the need for exemption certificates as provided for in this bill. This would result in a reduced amount of administrative expense to the Treasury Department in handling remittals and certainly would reduce the number of individual refunds to taxpayers. This in itself would be a savings to the Government.

As stated previously, the Georgia Bankers Association is opposed to the withholding provision of this bill. We realize, however, that if this revenue measure is to be a balanced tax package some additional revenue must be provided to offset some of the exemptions or credits also allowed in the bill. If it is the concensus of the members of this committee that the withholding provision must be incorporated in the bill, we believe that certain corrective steps should be taken.

We respectfully request that the following changes be made and we believe that they would simplify the administration and the practical application of implementing this portion of the bill:

1. The requirement for annual filing of exemption certificates should be abandoned. Banks should be permitted to rely upon such certificates until revoked by the individual or organization.

2. Pension trust, other tax-exempt organizations and individuals not liable for the payment of income tax should be permitted the same exemption certificate procedure for individuals and interest.

3. Exemption certificates should be made available for nontaxable trust beneficiaries by making bank trustees and nominees the withholding agents.

4. In the case of interest coupons on bearer bonds, the first receiving bank should withhold the necessary amount of tax from the individual, but should remit the coupons for collection at par, retaining the amount withheld for later transmission to the Treasury.

5. Banks should be adequately compensated for the additional costs of withholding.

6. The effective date of any withholding provisions should be delayed so that the payers of interest and dividends have at least a year to adjust their operations to handle withholding.

7. That accounts receiving less than $48 annually from interest or dividends not be subject to withholding.

This statement is a brief résumé of the collective views of the members of the Georgia Bankers Association. The membership of GBA respectfully request that the opinions expressed in this statement be taken into consideration by members of the committee in their deliberations on the Revenue Act of 1962 (H.R. 10650).

The CHAIRMAN. Thank you, Mr. Lindsey.

Mr. LINDSEY. Thank you.

The CHAIRMAN. The next witness is Mr. Howard J. Stoddard, Roth Committee for Tax Equality.

Will you proceed, sir, Mr. Stoddard.

STATEMENT OF HOWARD J. STODDARD, CHAIRMAN OF THE BOARD, MICHIGAN NATIONAL BANK

Mr. STODDARD. Mr. Chairman and members of the Senate Finance Committee, my name is Howard J. Stoddard. I am chairman of the board of the Michigan National Bank, with headquarters in Lansing, and operating 18 banking offices in 8 outstate Michigan cities. I am also chairman of the Michigan Bank, NW., in Detroit, operating 12 banking offices in that city. My testimony is being given on behalf of the Roth committee, one of the earliest groups engaged in the struggle to achieve tax justice and equality between competing financial institutions.

The two banks over which I have executive direction have total assets of approximately $800 million, of which some $290 million is invested in real estate mortgages, largely homes, thus making our banks major holders of residential mortgages in Michigan.

President Kennedy, in his tax message to Congress on April 20, 1961, recommended, among other things, the correction of inequities in the present tax laws. One of the most glaring has been the inequality of taxation which has existed between commercial banks, savings banks, and savings and loan associations, as shown by the following 10-year statement of tax payments (in millions):

	Federal taxes
Insured commercial banks	$9,066
Insured mutual savings banks	10
All savings and loan associations	47

The President's message, without indicating the actual additional Federal revenues as set forth in a report by the Federal Treasury several months ago, which would be received (estimated at $416 million) covered the situation as follows:

> Some of the most important types of private savings and lending institutions in the country are accorded tax-deductible reserve provisions, which substantially reduce or eliminate their Federal income tax liability. These provisions should be reviewed with the aim of assuring nondiscriminatory treatment. Remedial legislation in these fields would enlarge the revenue and contribute to a fair and sound tax structure.

The mutual savings banks and savings and loan associations, with assets of $125 billion have, since the President's message, kept up a constant drumfire of opposition to being made subject to just and equitable taxation. Every argument which they have advanced to preserve their virtual tax-free status has been fully and completely answered, either by banking groups or the Treasury Department

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Report of July 1961 to the House Ways and Means Committee. However, it is our purpose to analyze the residential mortgage requirements of this country, and determine whether or not the claims which they make in this regard for a virtual tax-free status are justified on the grounds of a national economic policy.

One of the last remaining justifications for their continued refusal to bear their fair share of the national tax burden is an emotional appeal, unsupported by factual evidence. They claim that taxation would cause a reduction in the interest and dividends which they can pay to savers, thus curtailing the flow of funds into the residential mortgage market. This in turn, so they allege, would result in fewer homes being built, and thus lead to a serious depression in our economy. There is substantial evidence that the payment of tax by the mutual thrift institutions would not sufficiently affect their dividend payments as to cause any appreciable change in their savings and share growth. Indeed, the most authoritative analysis of this subject prepared by the Treasury indicates that the likely effect of the payment of equitable taxes would be merely to slow the annual increase in the dividend rates witnessed in recent years. Thus, there could be no significant dislocation in the flow of funds to the mutual savings institutions.

The savings and loan associations have spent millions of dollars in advertising—calling attention to the role they play as the major source of funds for home construction. It is obvious that if commercial banks could treat mortgage income on a tax-free basis, which in effect is what savings and loans can do, there would be a virtual Niagara flow of funds into such loans. However, to claim a position of public virtue because of a tax subsidy, is sheer sophistry.

Summary of residential mortgage financing for the period of 1950-59: 11.6 million units were built during this period at a cost of $158 billion. The average cost per unit in 1959 was $13,240. Due to cash payments, amortization, and despite loans on existing properties, the increase in the mortgage debt was but 65 percent of construction expenditures. The debt grew $102 billion, from $45 billion to $147 billion, and was divided as follows:

[Dollars in billions]

Lender	Jan. 1, 1950		Jan. 1, 1960	
	Amount	Percent	Amount	Percent
Savings and loan associations	$11.4	35.4	$52.6	35.4
Mutual savings banks	5.6	12.4	22.5	15.3
Commercial banks	8.7	19.3	20.4	13.8
Life insurance companies	8.4	18.7	27.2	18.5
Individual and other	10.9	24.2	24.3	17.0
Total	45.0	100.0	147.0	100.0

The above table, which applies only to residential mortgages, is very misleading, inasmuch as a home itself is not complete without sewers, sidewalks, streets, furniture, and household appliances, as well as an environment of schools and public buildings. If the loans which the comercial banks made in these areas were added to the above totals, then the lending of banks for the creation and maintenance of family dwelling units would doubtless be larger than that of any other.

FORECAST FOR THE PERIOD 1960–69

Three major studies have recently been made to estimate the volume of residential mortgage construction and mortgage financing requirements for the 1960's. One study was by the School of Business of the University of Michigan; another by the School of Business of the University of Indiana. The third was by the Federal Housing and Home Finance Agency.

The Michigan study estimate was 13.7 million units for the 1960 decade; the Indiana study 13.5 million, and the Housing and Home Finance Agency 16 million units. The studies indicate that there will be an adequate supply of mortgage funds forthcoming in the decade of the 1960's to meet the needs of the anticipated housing demand. The Housing and Home Finance Agency report, the most detailed of these studies, indicates that there will be a substantial surplus of mortgage funds available. The agency estimates that after the financing of the 16 million new housing units anticipated for the 1960's there will still be $21.4 billion surplus funds available to finance mortgages. This is a considerable sum of money, and a more than adequate margin of safety for meeting the housing demands of the Nation.

Since 1959 the number of nonfarm housing starts has been below the Housing and Home Finance Agency estimate. Thus, the surplus of funds may well be greater than the agency anticipates.

A further indication of the more than adequate supply of residential mortgage funds is the fact that savings and loan associations have been devoting an increasing proportion of their lending to loans for purposes other than the purchase or construction of homes. As the Federal Home Loan Bank Board indicated in its January 1962 release on mortgage lending activity:

> The most accelerated gain in mortgage activity during the opening month of 1962 was reported for miscellaneous lending, a pattern evident since the summer of 1960. Loans for a variety of purposes, such as financing alterations or refinancing of existing homes, financing apartments or land developments, et cetera, together increased by almost three-fifths over January 1961, and comprised one-third of overall lending contrasted with 29 percent in the previous years.

Thus, it becomes apparent that the savings and loans recognize the slowing rate of growth in the demand for housing. This was emphasized in a recent address by C. Elwood Knapp, former president of the United States Savings & Loan League, who said:

> The real, basic housing demand has been satisfied for the present. You see the evidence of this in the vacancy ratios, the number of realtor listings and the length of time it takes now for a builder to sell homes as compared with a few years ago.

The recent action of the Federal Reserve Board in raising the ceiling on the rate of interest which can be paid by commercial banks to 4 percent will have a tremendous effect upon the residential mortgage market. In the first 2 months of 1962, the growth of savings and time deposits in the commercial banks was more than $4 billion, as compared with less than $2 billion in the same period for 1961. It is true that a portion of this growth represented corporate funds being invested in time certificates, but nevertheless we know that a large amount of this is true savings deposits, of which the major portion will be seeking investment in real estate mortgages.

We now witness the giant commercial banks located in New York City vigorously organizing departments to make mortgage loans, and investing their savings funds across the country and purchasing mortgages as far away as California, Texas, and Florida. I note that the president of the United States Savings & Loan League was cognizant of this in his recent statement that "competition from the commercial banks in the home mortgage market field may be a more serious threat to associations than the new bank savings rates."

I would like to attempt to answer, at this point, a question that was posed by a member of the committee earlier this morning, that of the growth of time and savings deposits in banks, and how is it that only $200 million has found its way into residential mortgage financing?

The answer is very simple. This flow of funds came on suddenly, came on unexpectedly. Banks had no inkling, prior to the Federal Reserve raising of the ceiling on interest to 4 percent, as to what would happen. The flow of funds assumed a proportion that we have not been accustomed to in many years.

However, between the time you accept the deposits and the time you put deposits to work there is naturally an interval. During this lag banks could easily purchase, as many of them did, some tax-exempt municipal securities. Others used the time to get ready to make mortgage loans.

I would like to refer to just one case in Michigan. Our own bank and the largest bank in the State of Michigan together purchased all of the FHA- and VA-insured mortgages in Michigan owned by the Federal National Mortgage Association, and this month we are taking delivery on more than $100 million of such mortgages.

The reason for doing this is that there are not at the present time existing in Michigan enough good residential mortgages to meet our mortgage loan requirements, and this process is being repeated and multiplied throughout the United States.

Senator BENNETT. What you are telling us is that you are going into the secondary market rather than the primary market.

Mr. STODDARD. Because the loans are not available in the primary market, we have to move into the secondary market; yes.

Now, Mr. Chairman, I will continue with my prepared statement. We must also remember that during most of the 1950 decade, the average rate of return paid to the savers by mutual savings banks and savings and loan associations was generally 1 percent higher than that of commercial banks. There are three reasons for this situation:

First, the Federal Reserve Board imposed a ceiling of 2½ percent, and finally to 3 percent—of course, it is now 4—which banks could pay on savings accounts. No such limitation was imposed on Federal savings and loan associations.

Second, as already shown, the mutual savings banks and savings and loan associations paid Federal income taxes of about 1 percent of their net income, whereas banks paid 40 percent. Here again I might say that one of the major reasons for this, the majority of the banks in the United States are in the low bracket and pay at the most 35 percent, which has a tendency to bring the average down for all banks.

That is the single largest reason for this not being up to the 52 percent; the other, of course, the tax-exempt income on municipals.

In the year 1960, if the banks had been on the same tax basis as the savings and loan associations, they could have paid 5 percent to their savings deposits and still shown the same earnings to their shareholders.

In the year 1960 the banks in the United States paid Federal income taxes of $1,384 million. Had they not paid that tax, they, like savings and loans, could have paid it to their savings depositors. That sum of $1.4 billion paid in taxes, added to the $1,785 million which the banks did pay in interest on their deposits, would have permitted the commercial banks to have paid at least 5 percent on their savings deposits and still made as much return for their shareholders.

I might also point out at this stage that the banking business is not a high-profit business. From 1951 to 1960, inclusive, banks' average annual earnings on capital funds for a 10-year period were but 7.8 percent, almost 50 percent below the average of industrial corporations.

Of this amount, banks paid out in dividends to shareholders 3.6 percent, and retained the balance to build up a surplus as protection for the depositors.

The banking business, as such, is not the profitable industry that it is often regarded when you compare it with other types of industries in the United States.

Third, mutual savings banks and savings and loan associations, although indicating to the public that their savings were available on demand, never provided liquidity in their assets to meet heavy withdrawals. As a matter of fact, on December 31, 1961, the mutual savings banks had 76 percent of their deposits in long-term mortgages, and the savings and loan associations 97 percent of their share accounts. Generations of lending experience by banks of deposit have proven the wisdom of liquidity to meet unexpected withdrawals. The combined assets of mutual savings banks and savings and loan associations are almost equal to half those of commercial banks, yet neither the management of the former nor the governmental supervisors have urged a policy to establish overall liquidity such as has been done with commercial banks. It is obvious that an institution must sacrifice earnings in order to provide liquidity, and yet there has been a great disparity between commercial banks and savings and loan associations in this respect.

I might point out here that some of us in our schooldays received the classical education in banking and economics which taught us that a time deposit in a bank was one thing, and a checking account or commercial deposit another. I would make the statement today, without fear of contradiction, that probably not one out of a hundred American citizens today believes other than that he can go to his bank, he can go to the mutual savings bank, he can go to his loan association and he can get back his money any time he wants it.

This classical theory of investing demand money in long-term obligations no longer exists, at least in the mind of the average American who makes a deposit or places his money in a share account.

The insured savings and loan associations, despite the commercial bank competition for savings at the increased rates, report a net in-

crease in savings for the first 2 months of 1962 of $1 billion, as compared with $1.1 billion for the same period in 1961. The net increase in deposits of mutual savings banks for the first 2 months of 1962 also compared well with 1961.

I sat through the hearing in the House Ways and Means Committee and heard one savings bank official after another testify that if they were taxed it would cause them to reduce their dividend rate by a half of 1 percent and, as a result, their institutions would cease to attract money.

Since that date, the Federal Reserve has permitted banks to go from 3 percent to 4, far more than the one-half percent they were talking about. Yet the savings and loan associations in the first 2 months of this year came within $100 million of adding as much to their structure as they did before.

If there is any one segment of the financial lending market in which there is no shortage of funds for the foreseeable future, it is in the residential mortgage area. The great danger is that such enormous amounts will be seeking investment in these mortgages that it will lead to unsound lending practices. Commercial banks, except for FHA- and VA-insured mortgages, are restricted at the most to monthly amortized loans for 75 percent of the appraised value of residential properties, and for 20-year periods. On the other hand, savings and loan associations are permitted to make conventional loans of 90 percent of appraised value and for even longer maturity. In 1960 the savings and loan associations made only 8 percent of their loans on an insured basis. This is in sharp contrast with 36 percent of such loans in 1946. It suggests a willingness to depart from sound lending standards in order to acquire volume and a higher rate of interest.

We listened to the testimony before the House Ways and Means Committee, where the savings and loan associations and savings banks were attempting to justify their 12-percent tax-free loss reserve. They do not need it if they follow sound lending practices.

If they feel they must lend into these more extreme limits, the FHA and the VA give them an insured mechanism by which to do it. But they have not been using Government-insured loans. They have left the FHA and the VA programs which have been picked up largely by banks and other lenders, because they cannot make the money loaning in the FHA and the VA field they can by making conventional mortgage loans.

H.R. 10650, if adopted in its present form, would still not place the commercial banks, mutual savings banks, and savings and loan associations on a fair and competitive basis. The commercial banks have been permitted to deduct from their earnings a reserve for loan losses, before computing their Federal income tax. This reserve, which averages for all commercial banks 2.4 percent, is computed on the growth year by year, of the risk loans made by the banks. One provision for taxation in H.R. 10650 gives to mutual savings banks and savings and loan associations a similar right to set aside 3 percent of their growth in all loans on an annual basis, before computing their tax liability. As has already been shown, and will be emphasized in additional testimony, this 3-percent formula is more than adequate as a loss reserve, for a properly made, properly serviced, residential

real estate mortgage is, next to a Government bond, the soundest asset in this country.

Here again I would like to give to the Finance Committee the benefit of a personal experience.

In 1933, the late Jesse Jones gave me the assignment of going to Detroit, Mich., to determine how much the RFC could safely loan to a closed bank in Detroit that had $156 million of residential mortgage loans in its portfolio.

Our problem was to find out how much the RFC could loan safely on $156 million of residential mortgage loans.

Detroit at that time was not a pleasant place to be. About everything that could happen had already happened to that community. Please remember that these mortgage loans were all unamortized, they were a straight 5-year loan; interest and taxes were delinquent; people were out of employment. It was rather a dismal picture.

At the completion of our investigation we recommended, and the RFC Board made, a loan of $148 million on the $156 million of residential mortgage loans in the city of Detroit.

We then proceeded to call these people in; we gave them a new 10-year deal. We took the accumulation of taxes, interest, and insurance and all their delinquencies, put them into a new loan, gave them 10 years on a monthly amortized basis to pay it, including taxes, interest, and insurance.

The port folio paid out almost in full, and the Government got all its money back.

Even in the worst depression period the country has seen, no asset in my experience as a banker has held up better than a well-made, well-serviced, residential mortgage loan. For anybody to tell you that a 12-percent reserve for loan losses is required is pure fantasy without any relation to facts at all.

The bill also provides an alternative, which gives an exemption of 60 percent of the net income of the mutual savings banks and savings and loan associations, and taxes but 40 percent. We are wholly at a loss to understand the logic or fairness of this latter alternative, and believe it should not be permitted to set a precedent in our Federal tax structure. The Treasury Department has already claimed this exception to be very excessive, and if one were granted, it should be for not more than one-third of the net income. There is nothing in the history of mortgage financing in this country nor any foreseeable future contingency which suggests but that a 3-percent reserve for loan losses, based on annual growth in risk loans, is entirely adequate.

The Congress in 1951 recognized that a Federal tax should be imposed on mutual savings banks and savings and loan associations. It was not contemplated when such legislative action was taken, that a conference committee amendment in the form of a 12-percent reserve for losses would practically nullify the effect of the proposed taxation. As early as 1951 the mutual savings banks and savings and loan associations had become of age, and certainly with present assets of $125 billion, they are not entitled to such preferred status in the community of American business corporations. They should no longer seek to escape the responsibility of their fair and just share of the national tax burden, and should not come to this committee pleading for further relief.

To summarize, the question we must answer is simply—will there be a shortage of residential mortgage money if the mutual savings banks and savings and loan associations are subject to the same Federal income tax rates as are commercial banks? The answer is emphatically "No." There will be no shortage of mortgage money during the 1960 decade.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Stoddard.

Senator Kerr?

Senator KERR. No questions.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Mr. Chairman, I have a question or two.

First, I would like to welcome my friend Howard Stoddard before the committee. He, like George Romney, is another Utahan transplanted to Michigan.

Mr. STODDARD. Oregonian, Senator, I am sorry. I married a Utah girl, of which I am very proud.

Senator BENNETT. George was born in Mexico, but if you pass through Utah on the way, we claim you.

Mr. STODDARD. I would not say I would not have been proud to say that, but I would not have been truthful.

Senator BENNETT. I still claim him. On pages 54 and 55 of the bill there is a new definition of domestic building and loan associations. This new definition permits these associations to invest their deposits in loans secured by an interest in real property of a residential nature, and in other loans authorized by section 5(c) of the Home Owners Loan Act.

Does this new definition extend to the associations' lending powers they have never had before?

Mr. STODDARD. At the present time most associations can loan 20 percent of their assets in other than residential mortgage loans. Within the last year or year and a half they have been rapidly filling up this allocation because of their inability to get good conventional mortgages, residential loans at the rate they want it. They have moved into the motel field, the country club field, the apartment house field, and many others. At the present time, most associations can—I may be wrong on this, but I think that most associations can—loan 20 percent of their assets or their share accounts in other than one- to four-family residential mortgage units.

I do not know whether this particular language adds to that or not. I have a hunch it does, but that is all.

Senator BENNETT. Some savings and loan associations have a stock base rather than being completely mutual. Do you have any idea what the proportion of the industry is that is represented by these stock companies?

Mr. STODDARD. I did know it once. It is either 8 or 13 percent. I think it is probably 13 percent. Most of them are located in the State of California. There are many States which prohibit it.

In our own State of Michigan, for example, you cannot have a stock company. I noticed in our neighboring State of Illinois, many mutuals recently have been toying with the idea of converting into stock companies.

Senator BENNETT. I know it is permitted in my State of Utah, and some of the mutuals have become stock companies.

Do the stock companies enjoy the same tax status as the mutual companies?

Mr. STODDARD. They do.

Senator BENNETT. Turning over to the banking side, there are still, I suppose, some stock saving banks?

Mr. STODDARD. I believe there are; yes.

Senator BENNETT. And they are taxed on the same basis as the stock commercial banks?

Mr. STODDARD. Yes. I think this committee will be fortunate to hear from a man I met here today from Georgia who, I believe, operates a stock savings bank. He is taxed just as commercial banks are taxed.

Senator BENNETT. So we have some other areas of possible tax inequity because of the changes in the pattern inside the two agencies.

Mr. STODDARD. That is correct.

Senator BENNETT. Maybe, Mr. Chairman, what we should do is to consider a proposition to give commercial and stock savings banks the right to pay a 40-percent tax on their profits earned on mortgage business, and provide equality that way. How would you like that?

Mr. STODDARD. Well, you would send me home happy if you want to do that, but I'm afraid it wouldn't raise much tax revenue.

Senator BENNETT. I have no further comment.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Mr. Stoddard, just so that I can be clear, in your statement you say:

> Second, as already shown, the mutual savings banks and savings and loan associations paid Federal income taxes of about 1 percent of their net income, whereas banks paid 40 percent.

Is this 40 percent of taxable income or what?

Mr. STODDARD. Yes. The operating profit of commercial banks in 1960—this is from the Federal Deposit Insurance Corporation report—was $3,791 million. They had a nonoperating loss of $404 million, leaving a gross profit of $3,387 million on which they paid income taxes of $1,384 million.

The income they get from municipal bonds is tax exempt, but I would like to point out, Senator, that there is no particular percentage in that.

We faced that problem in our own bank this year. The rate that we could pay on savings was increased to 4 percent. We elected to pay 4 percent, and so notified our people.

We could then do one of two things: We could exchange some Government bonds we had, yielding us 3 percent, for some tax-exempt municipals yielding us 3 percent, and in this way cut down our income tax, or we could buy municipals, but we elected to go the other way.

We could go out and purchase $50 million of insured mortgages on a 5½ percent yield basis in the secondary mortgage market, which we did. So the fact that you are exempt on a part of your income does not help you much in the banking business because you can either take

a 3-percent tax-exempt municipal or a 6-percent loan. It is six of one or half a dozen of the other.

Senator CURTIS. I understand that. I just wanted to get it clear in my mind as to what you referred to.

What are the restrictions on what Federal savings and loan companies can loan money for? Are there any?

Mr. STODDARD. Yes. As I understand it, 80 percent of their loans have to be in the field of one- to four-family residential living units, and some 20 percent can be loaned for a defined class of other type loans.

There are places that I do not think they can loan this 20 percent, but they certainly can in the mortgage field.

Senator CURTIS. What does that 20 percent have to consist of?

Mr. STODDARD. It is 20 percent either of the share accounts or of their total assets, I am not quite sure.

Senator CURTIS. What can they loan it for?

Mr. STODDARD. They can loan it and take a mortgage on a property of the United States Steel Corp., for example.

Senator CURTIS. But must it be real estate, a real estate mortgage?

Mr. STODDARD. I think it must be real estate; yes, sir. They can make so-called title I FHA improvement loans, but that is related closely to real estate. I would say, for practical purposes, in the real estate field; yes, sir.

Senator CURTIS. In other words, substantially all of it must be made on real estate of some kind.

Mr. STODDARD. Yes. I think that is correct.

Senator CURTIS. What are the restrictions on a national bank?

Mr. STODDARD. The national banks can loan on insured mortgages, FHA mortgages; there is no restriction as to the amount of our savings we can loan there.

Senator CURTIS. What else can they invest in?

Mr. STODDARD. We loan on every kind of imaginable thing for which a human wants to borrow money from a bank.

Senator CURTIS. Are they restricted in any investment and, if so, what are they?

Mr. STODDARD. Oh, yes. We are restricted as to the type of corporate bonds we can buy.

Senator CURTIS. And the percentages?

Mr. STODDARD. No, not necessarily. I did not finish my answer to you fully, Senator.

Senator CURTIS. Excuse me.

Mr. STODDARD. We can only lend 60 percent of our savings and time accounts in conventional mortgages. On FHA, however, there is no restriction.

Senator BENNETT. You cannot invest in corporate stocks?

Mr. STODDARD. No; we cannot invest in corporate stocks.

Senator CURTIS. That is what I wanted to have you comment on. What can you invest in and loan for and what can't you?

Mr. STODDARD. We are denied, very properly, investment in stocks. We cannot hold any stocks. Our limitation as to what we can invest in real estate is confined to our own banking house and maybe a parking lot next door. We cannot go out and buy raw and unimproved land, or loan in that field, which many savings and loans can.

So, we have quite definite restrictions in the mortgage lending field so far as real estate is concerned. Other than that, the places in which a bank loans money are so numerous that it would be impossible for me or anyone else to sit here and go through a list of items on which we can loan money.

Senator KERR. Would the Senator yield?

Senator CURTIS. Yes.

Senator KERR. What percentage of your loanable funds can you invest in real estate mortgages?

Mr. STODDARD. For so-called conventional noninsured mortgages, we can invest 60 percent of our time and savings deposits.

Senator KERR. Sixty percent of your time and savings?

Mr. STODDARD. Yes, sir. If the bank had $100 million in time and savings deposits, it could loan $60 million in residential and other real estate mortgages.

Senator KERR. Thank you.

Mr. STODDARD. That is the limitation, except for insured mortgages. That was removed some time ago. It does not apply to FHA-insured mortgages. It does not work against this percent.

Senator KERR. And what you invest in insured mortgages is not considered as against what you can lend; that is, the 60 percent of your time and savings deposits in conventional mortgages?

Mr. STODDARD. That is correct, Senator Kerr; yes.

Senator CURTIS. Mr. Chairman, I shall not take more time.

Senator KERR. Then I would like to ask another question. What rate of interest do you have available now for conventional home mortgage loans?

Mr. STODDARD. Six percent is the going rate. If a man walks into our office and puts up a good argument and has a good loan, and we go down to 5.5, we do not let him go out of the door without going to 5.5. Basically in Michigan, the rate of interest is from 5.5 to 6 percent on mortgage loans.

Senator KERR. What period of time?

Mr. STODDARD. On conventional mortgages we can now go as long as 20 years, providing the loan is amortized monthly: interest, principal, taxes, and insurance.

Senator KERR. There is no big balance at the end of the term?

Mr. STODDARD. No.

Senator KERR. It is completely amortized at the end?

Mr. STODDARD. Yes, sir.

Senator KERR. Is the 6 percent on the remaining balance?

Mr. STODDARD. It is 6 percent on the unpaid balance.

It is an actual, "honest," if I may use the expression [turning to Senator Douglas], disclosure of 6 percent; yes, sir.

Senator DOUGLAS. Thank you. I appreciate that very much, and I wish the other bankers would take that to heart.

Senator KERR. Thank you, sir.

The CHAIRMAN. Senator Hartke.

Senator HARTKE. I did not hear you, I am sorry I was not here, when you made the statement—outside of your statement here—in regard to the time deposits which had increased in the first 3 months for commercial banks.

Mr. Stoddard. In the first 2 months, the time deposits and savings have increased some $4 billion in the commercial banks.

Senator Hartke. $4 billion?

Mr. Stoddard. Yes, sir.

Senator Hartke. Do you have the amount that was increased in the amount of nontaxable securities or government securities?

Mr. Stoddard. No, I do not have it.

Senator Kerr. In what, Senator?

Senator Hartke. In tax-exempt bonds.

Senator Kerr. Municipals.

Senator Hartke. Municipal bonds or other similar bonds.

Senator Kerr. Tax-exempt.

Senator Hartke. Tax-exempt securities. He said he did not have that, as I understand it.

Mr. Stoddard. No, I do not have the amount.

Senator Hartke. I am sorry I was not here again, but did you give the amount that had been invested from your time deposits and savings in these first 3 months, and then as to mortgage loans?

Mr. Stoddard. Yes. I was curious, Senator, when I heard your statement this morning about only $200 million going into mortgage loans because our own bank and one other in Michigan have already contracted for $100 million of residential mortgage loans.

Senator Hartke. Maybe you have done half the business.

Mr. Stoddard. I know one bank out on the west coast that is seeking, at the moment, $200 million of good residential mortgage loans. The timelag is such that I do not think you can take only 2 months and use that as any guide to predict what will happen.

Senator Hartke. I gather from what you said, though, these were not in primary mortgages.

Mr. Stoddard. No, we cannot get the primary mortgages at the moment.

Senator Hartke. And yet you cannot get the primary mortgages, but the banks are organizing an aggressive campaign to get them.

Mr. Stoddard. Yes. When a bank is paying 4 percent on savings it looks around to see where it can invest these savings. A bank that can get a good 6-percent residential mortgage is going to get that mortgage if it can. There is enough margin between the 4 and the 6 percent to justify seeking that type of investment.

Senator Hartke. I understood you to say they were not available to you.

Mr. Stoddard. Not at the moment, no. Building during the winter months is very slack in our country. We do not get building underway until late April or May.

Senator Hartke. I see.

Mr. Stoddard. So the flow of mortgages into a bank at the moment is very low.

Senator Hartke. Is there anticipation by the banks that it is going to increase substantially?

Mr. Stoddard. As we examine the field in the State of Michigan, which has a population of 8 million, the major reason we decided to buy in the secondary market was because we did not believe in the next year in Michigan there will be enough new mortgages offered to banks to satisfy our loan requirements.

In other words, the supply of money will be substantially greater than the demand for mortgage loans in the State of Michigan for the coming year.

Senator HARTKE. In substance, then, what you are saying is you are aggressively organizing your banking activities to secure secondary mortgages.

Mr. STODDARD. Well you do not have to organize aggressively to do such, Senator. In periods when the demand exceeds the supply of funds. The Federal National Mortgage Association has bought, I think altogether over the years, some $12 billion of mortgages. They have several billions now of unsold mortgages on hand, and at a price they will sell those mortgages to banks or others who need them as investment.

At the moment both the Federal National Mortgage Association and the VA are out merchandising mortgages in their portfolios to encourage the banks to buy them and carry them in the banks' portfolios where they really belong, anyhow.

Senator HARTKE. You do not need an aggressive campaign to get those funds out of their portfolio into yours.

Mr. STODDARD. No. That is just a question as to whether you pay the price that they ask.

Senator HARTKE. You do not anticipate there is going to be any substantial increase in the primary mortgage field?

Mr. STODDARD. Quite to the contrary, I look for a slight decrease in the rate of interest that borrowers will have to pay on mortgage loans.

Senator HARTKE. Then I am confused as to why you are aggressively organizing to secure mortgage funds in the primary field which are not going to be existent.

Mr. STODDARD. If we do not organize, Senator, to get these mortgages, somebody else will get them. We are going to pay 4 percent on savings, and we want to get the 6 percent or 5.5 to 6 percent return for investing these funds. It is just that simple with us.

Senator HARTKE. It sounds to me like what you are going to do is go into the secondary mortgage field with an aggressive group in a market which you, by your own admission, say does not exist.

Mr. STODDARD. Maybe I have not made myself clear.

I will just state the problem that our board had to face. In our own bank, since the first of the year, our time and savings deposits have increased $36 million. On that we are paying approximately 4 percent. We have to put that money to work.

Senator HARTKE. You have got $36 million, is that right?

Mr. STODDARD. Of an increase in deposits since the first of the year.

Senator HARTKE. $36 million?

Mr. STODDARD. That is right.

Senator HARTKE. All right.

Mr. STODDARD. We have to put that money to work. We can buy tax-exempt municipals, which we decided not to do.

Senator HARTKE. You decided not to do that?

Mr. STODDARD. That is correct.

Senator HARTKE. All right.

Mr. STODDARD. We can go out and buy from FNMA, FHA, and VA mortgages that will yield us 5.5 percent. We elected to do that.

So, a very substantial portion of this increase in deposits has already been committed in that field. We have taken the mortgages away from a Government instrumentality and put it back in the commercial bank where it belongs.

Senator HARTKE. To what extent have you, at this present time, either contracted for or committed yourself on the $36 million?

Mr. STODDARD. Our own bank and one other bank larger than ours in Michigan have bought all of the VA and FHA mortgages now available in the State of Michigan.

Senator HARTKE. How much was that, do you know?

Mr. STODDARD. Better than $100 million.

Senator HARTKE. $100 million.

Mr. STODDARD. Yes, sir; except we did not buy those on which they are asking for a premium.

The mortgages of the Federal National Mortgage Association that bear a 5.75 percent interest rate are selling at a premium of 102 or 103. We did not buy those. In a few months we might be sorry we did not, but we did not. We just bought those we thought we could buy for less.

Senator HARTKE. You paint a rather gloomy picture then for the homebuilding industry.

Mr. STODDARD. Oh, no. Quite the contrary, the homebuilding industry will have all the money it needs. The homebuilding industry is going to have all the money it needs, as it has now. There is no lack of money.

Homebuilding is not suffering anywhere in the United States today because a homebuilder cannot get mortgage money. Mortgage money is out seeking builders to secure mortgage loans. We are chasing them down every street we know of.

We follow the steam shovel around to the lots in every community when we see them, to try to see if we cannot make a mortgage loan.

Senator HARTKE. But you do not see a substantial increase in the homebuilding rate in Michigan?

Mr. STODDARD. No. I would think that probably six——

Senator KERR. He said an increase in the interest rate. I think he said the interest rate.

Mr. STODDARD. I said interest rate.

Senator HARTKE. Then I misunderstood you. I thought you told me a few moments ago that you did not feel there was an opportunity for investment in the primary mortgage field of a substantial nature in Michigan, that it would be in the secondary market.

Mr. STODDARD. We have exhausted the secondary market. We are going to have enough funds to do that and still loan all the funds in the primary market that we can find places to lend.

Senator HARTKE. Then I asked a question which I thought maybe I misunderstood you, as to how much you had invested so far in the primary market, isn't that right, in the first 2 months?

Mr. STODDARD. Yes. We have obligated ourselves to purchase $50 million of insured mortgages.

Senator HARTKE. In the primary market?

Mr. STODDARD. No; in the secondary market. In the primary market, at the end of February we had about $6 million of commitments outstanding. I have not seen the March end-of-the-month figures.

Mr. HARTKE. $6 million?

Mr. STODDARD. There are people who come in and ask for loan commitments in advance. We had about $6 million of such commitments; yes, sir.

Senator HARTKE. My understanding, not in regard to the rate of interest, but as to the rate of increase in the primary mortgage field, was, you said, you did not anticipate an increase.

Mr. STODDARD. We will be confronted with the task of investing approximately $5 million a month in real estate mortgages during all of 1962.

Senator HARTKE. Is that all, $5 million a month in the primary market?

Mr. STODDARD. In the primary market, in addition to what we have already done in the secondary market.

Senator HARTKE. In addition to what you have done in the secondary market.

Mr. STODDARD. That is right.

Senator HARTKE. Which means in the next 9 months about $45 million will go into the primary market, is that right?

Mr. STODDARD. Yes. But there is another factor that works against our coming up with a more impressive increase. Mortgages are all on an amortized basis. Even 20-year mortgages do not stay with the lender for 20 years; the average is closer to 12 years. As a result each month we have to make a very substantial volume of new mortgage loans to just meet the payments we get in from the amortization of the older ones.

Senator HARTKE. So, in substance, what you are saying is basically you anticipate your portfolio is going to increase in the primary mortgage field since you have a substantial increase in time and deposits which are available if you had the demand in the primaryl market mortgage field.

Mr. STODDARD. We live in a competitive world. If we get busy and go out and get the mortgage loans and our competitor is not quite as busy and does not get them, we come off a little better than he does. That is just a matter of internal competition between banks and savings and loans.

Senator HARTKE. I have gone around several times, and I am going to ask you again. But what I have come out with as a conclusion, and I just want you to know what you have left me with, you have left me with the impression—perhaps not the other members of the committee—that time deposits and savings have increased substantially as a result of the increase in interest rates; that this basically has gone into the secondary mortgage field and has presented, as far as the primary mortgage field is concerned, that it is not going to have any material effect on it whatsoever, not the question of the availability, but the actual investments so far as the banking facilities that you are controlling or that you see yourself.

Mr. STODDARD. Well, I guess I have not made my communication as clear as I would like, Senator, and I apologize for it. But what I am saying is this: At the moment our increase in time and savings deposits has exceeded our ability to place this money to work in the primary mortgage field. Therefore, we went into the secondary mortgage field.

Now, as the year goes on we will be able to generate more new mortgages in the primary field, and won't be back again this year in the secondary mortgage field.

Senator HARTKE. I understand that. But you will have to do something about these additional funds which go into your time deposits and your savings accounts and thus again it is going to present the question again to your board of directors as to whether you are going into tax exempt securities.

Mr. STODDARD. A part of that answer is obvious today. The Government bond market has become very strong in the last few months. At the moment Government bonds are selling for the highest price they have in many months. Many banks, taking on a 4-percent savings account at the moment and, not having any place to put it to work, proceed to buy a Government bond on which they get a 4-percent yield. So at least for the time being they are warehousing this money and not having it cost them anything to warehouse it until they can locate a more profitable place to invest it.

If they do not put it to work, they have a 4-percent cost which goes against their earnings. There is a great deal of warehousing right now on the part of banks, even in municipals.

Later on, if they can get a chance, to get a good 6-percent mortgage many of them might be disposed to sell a municipal and put the money to work in a mortgage—when they can get a good mortgage.

Senator HARTKE. That is all.

Senator BENNETT. I have one more question, Mr. Chairman.

For the record, what is the Roth committee?

Mr. STODDARD. I am very pleased that you asked that. Mr. Arthur Roth is here in attendance. He asked me to speak for the Roth committee. We have been associated together for many years.

Early in our association work he felt that the mutual savings banks, also members of the ABA, would not be happy with the movement to subject them to the same taxation to which commercial banks are subjected. Mr. Roth brought the matter to the attention of the American Bankers Associaion at their meeting in Chicago.

Many of us worked with him. It ended up that the mutual savings banks were not invited to leave the association, but many of them voluntarily did as the result of the action we took.

We felt it was difficult to set our association policy if a large segment of the membership was on a tax-free basis, and the others were fully taxed.

In the view of some of us who belonged to the association, it created a rather difficult working arrangement. Therefore, the Roth committee came into existence. That is the background.

Senator BENNETT. And the Roth committee is still in existence?

Mr. STODDARD. It is.

Senator BENNETT. What is its current function?

Mr. STODDARD. Working on securing, as nearly as we can, tax justice or tax equality between banks and savings and loans, and mutual savings banks. This is basically the same function it always has had.

Senator BENNETT. It is an arm of ABA?

Mr. STODDARD. No. It is an independent organization.

I might introduce Mr. Arthur Roth. I will also say this: He has the distinction of operating what many bankers consider the most successful bank in the United States today.

As we look over the returns from all the larger banks, judged by the standards that we apply to the banking business, Mr. Roth has, for many years, operated one of the most successful, useful banks in the United States. I am very pleased to be associated with him in the Roth committee.

Senator BENNETT. What is the name of his bank?

Mr. STODDARD. Pardon me?

Senator BENNETT. What is the name of his bank?

Mr. STODDARD. The Franklin National Bank in Long Island, N.Y.

Senator KERR. Where?

Mr. STODDARD. Long Island. Its headquarters are at Franklin Square, Long Island.

He just handed me a statement at noon. His institution is not small. On March 31 the Franklin National Bank had total assets of $876 million compared with $717 million a year ago, so he is doing very well.

The CHAIRMAN. Thank you very much, Mr. Stoddard.

Mr. STODDARD. I might say that we have worked in complete unity and harmony with the American Bankers Association and the three other national groups representing banking.

There has been a constructive exchange of views, give and take. So far as this problem of tax equality, I think we can say we are 100 percent united with these other associations.

The CHAIRMAN. Thank you very much, sir.

Mr. STODDARD. Thank you, sir.

The CHAIRMAN. The next witness is Mr. L. Shirley Tark, Bankers Committee for Tax Equality.

Proceed, Mr. Tark.

STATEMENT OF L. SHIRLEY TARK, BANKERS COMMITTEE FOR TAX EQUALITY

Mr. TARK. Mr. Chairman and members of the committee, my name is L. Shirley Tark. I am chairman of the executive committee of the Main State Bank of Chicago, Ill. I am here to express to this most important committee of the Senate, the views of the Bankers Committee for Tax Equality on a matter which concerns both the balance between revenues and expenditures in this tax bill and the competitive situation in the savings industry.

Our committee represents nearly 6,000 commercial bankers throughout the United States engaged in the field of commercial and savings banking. Mr. Chairman, these bankers are good citizens, interested in the affairs of their own communities, of their respective States and of the Nation. Right now, on April 11, they are especially aware of their rôle as taxpayers. As their representative, I come before you today in support of the conclusions contained in the Treasury Report of July 14, 1961, which could have collected in 1963 some $416 million in much needed Federal tax revenue by placing the savings and loan associations and mutual savings banks on essentially the same tax basis as the commercial banks.

May I again express my deep appreciation for the privilege of appearing before this committee on this, my third visit. In my first appearance for the Bankers Committee for Tax Equality in July 1951, our presentation was directed to the fact that savings and loan associations and mutual savings banks were not entitled to continued tax exemption, first, because they were no longer mutuals and second, because they were obviously engaged in business for profit and in competition with other taxpaying businesses. Passage of the Revenue Act of 1951 validated these contentions.

In April 1954, the Bankers Committee's testimony was directed to the proposition that the tax formula adopted in the Revenue Act of 1951 should be amended to tax effectively the net incomes of savings and loan associations and mutual savings banks at the Federal level. We pointed out that this objective could be accomplished by requiring these institutions to determine their bad debt reserves in the identical manner permitted commercial banks. The Bankers Committee has stressed, continually, its objective of attaining tax equality through legislation which would subject associations and savings banks to the payment of Federal income taxes on the same basis as competing banks rather than by legislation to relieve the commercial banks, themselves, from the payment of full taxes.

The original recommendations, submitted to the Ways and Means Committee in the Treasury Department Report of July 1961, completely affirmed the position of the Bankers Committee for Tax Equality in its presentations to your committee in 1954.

First, the Treasury concluded that—

> This special bad-debt reserve provision has kept these institutions (mutual savings banks and savings and loan associations) virtually tax-exempt because they may accumulate $12 tax free for each $100 of new deposits.

Second, the Treasury in its recommendations for taxation suggested that these institutions—

> be allowed to retain earnings tax free only in accordance with a bad-debt reserve formula comparable to the formula applied to commercial banks; that is, their bad-debt reserve ceiling would be limited to three times their average annual loss experience over the worst consecutive 20-year period since 1927.

The Treasury estimated that this would produce an average bad-debt reserve ceiling of between 2 and 3 percent of uninsured loans which would be comparable to the average ceiling of 2.4 percent applicable to commercial banks.

Third, the Treasury noted the possibility of alternative methods of taxation including (2) full taxation, and (b), transition over a period of either 2 or 4 years.

The Ways and Means Committee, in its tentative decision to tax in a more effective manner these mutual financial institutions, followed substantially the Treasury suggestions.

In its release of January 30, 1962, the committee stated:

> The committee tentatively decided on a system for taxing mutual savings banks and savings and loan associations. When the new provisions become fully effective (1966), such organizations would be allowed a loss deduction, in lieu of the present bad-debt reserve, equal to 3.5 percent of the net increase in all loans made during the year. Where such an organization can show, based upon its past loss experience, a need for a higher rate, under appropriate formulas to be developed by the Treasury Department, such higher rate could be used.

A transition period of 3 years was provided at less than the full rate of taxation. During the first year a tax equal to 50 percent of the regular tax would have been paid; 66⅔ percent the second year; 83⅓ percent the third year; and full tax the fourth year. New associations would be permitted to build reserves up to the 3.5-percent level.

In subsequent deliberations, the Ways and Means Committee departed from these conclusions it originally reached—frankly, we preferred the original position of the committee, based on the Treasury recommendations, to the formula which was evolved in H.R. 10650. Our committee now supports the latest position of the Treasury as outlined by Secretary Dillon before your committee on April 2, this year.

The committee's departure from its tentative decision, that is the Ways and Means Committee, introduced the concept of a transfer of tax-free income to a bad-debt reserve equal to 60 percent of taxable income. This would include 60 percent of the income derived from Government securities and Government-guaranteed loans. That is not permitted to the banks. In so doing, the House committee followed a most unusual tax theory by permitting the establishment of unlimited reserves[1] which bear little or no relation to experience or reality.

The Treasury characterized the old reserve of 12 percent under the 1951 law as a tax-free reserve for "catastrophic contingencies." However, even this reserve for catastrophic contingencies was subject to limitations—albeit these limitations were placed so high as to be virtually inoperative. H.R. 10650, providing for the perpetual accumulation of unlimited tax-free bad-debt loss reserves, cannot be justified on any theory, not even on the basis of the loss experience of the great depression. The mutuals have cited a study made by Economist John Lintner, of Harvard, to support their argument that they need maximum reserves.

This study, made for the Massachusetts savings banks of their experience during the 1930's, shows even the present reserves to be excessive.

Professor Lintner's study demonstrates that although the aggregate net losses on mortgages were 17.4 percent of the annual average portfolio outstanding during the years 1930–45, these losses actually amounted to only 1.16 percent of the portfolio of unforeclosed mortgages outstanding during each year of the period. It is especially significant that these losses amounted to less than one-fourth of the cash income provided from home mortgages during these same years.

Thus, across the board, the savings banks were able, easily, to absorb their mortgage losses out of current income.

A similar study of the experience of savings and loan associations for the period between 1930 and 1945, made by Dr. Raymond Goldsmith, of Princeton, indicates that their average annual loss amounted to less than 1 percent of the average mortgage portfolio.

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[1] "Your committee's bill does not impose any overall ceiling on the amount which may be accumulated by a mutual savings institution with respect to its reserve for losses on qualifying real property loans. However, your committee intends from time to time to review the status of this reserve to be sure that the balances maintained in these reserves remain reasonable in light of the overall requirements of the mutual savings institutions." H. Rept. 1447. Revenue Act of 1962. Report of the Committee on Ways and Means, p. 34.

Actually, there is little inherent risk in the making of properly amortized real estate loans, the principal business of savings and loan associations. Mortgage loans today are incomparably safer than heretofore; for since the days of the depression significant changes have taken place in the economy and in the banking business itself. These include the ever-increasing role of Government in economic stabilization as well as the monthly amortization of mortgages, monthly cash deposits, mortgage insurance, and deposit insurance.

May I refer to the report of the Committee on Finance, U.S. Senate, re the Revenue Act of 1951. Discussing the relative safety of real estate loans then made by mutual financial institutions, the report states:

> In any case, the investment of funds in real estate today is not a sign of insecurity in view of the fact that an important segment of such loans are backed by the Federal Government. * * * Moreover, even the other real-estate loans are more secure than formerly was the case because of the present general use of "declining balance" loans in lieu of the older "fixed amount" loans.

In the interest of getting directly to the point, Mr. Chairman, let us reduce this subject to its simplest form. What are we really talking about here? We are talking about financial institutions that have assets of nearly $125 billion and net operating income after the payment of dividends approaching $1 billion. Yet, H.R. 10650, the revenue bill of 1962 now before you, anticipates raising only $160 to $200 million in Federal income taxes from these so-called mutual thrift institutions. This is the result of allowing these institutions unlimited bad-debt loss revenues to which tax-free transfers can be added perpetually at a rate equal to 60 percent of income. Why are they entitled to this new form of limited tax exemption? Is this tax preferential justified? The Ways and Means Committee points out that the bad-debt reserves of mutual savings banks already have reached an amount equal to 10 percent of their deposits and those of savings and loan associations average 8 percent of their share accounts.

The Treasury Department has pointed out that savings and loan associations and mutual savings banks should accumulate their necessary reserves just as banks and other businesses—after taxes. The 6,000 bankers who constitute the Bankers Committee for Tax Equality want just that—tax equality.

Our committee seeks no favors for commercial bankers at the country's expense. We are not asking that tax equality be achieved by raising the bad-debt reserve permitted the banks to equal that granted the savings and loan associations. While our Federal Government's need for revenue is so great it would be immoral for the banks to seek equality by this method.

In fact, it seems apparent that our country's need for revenue is so urgent that maximum taxation right now is imperative. Every single day we delay means a loss of between half and three-quarters of a million dollars in tax revenues for defense and for the welfare of our citizens.

I hope I have made our position clear from my testimony. We believe, as does the Secretary of the Treasury, that the reserve provision now contained in H.R. 10650 is far more generous than is warranted by any reasonable concept of a bad-debt reserve. The alternative deduction of an arbitrary 60 percent of the retained income of these

organizations is obviously not related in any way to actual loss experience and can, in fact, be made in perpetuity. In effect, this latter provision removes nearly one-half of their income from taxation and in so doing greatly reduced the revenue to the Federal Government.

Since revenue is, of course, one of your committee's prime considerations, our group, while supporting Secretary Dillon's current position as outlined on April 2, wishes to call attention to the Secretary's previous recommendations contained in his report to the Ways and Means Committee July 14, 1961. Under "Methods of Taxation" the Treasury provides for: "(*a*) Full taxation" in a manner generally comparable to that imposed on other corporations and financial institutions in particular; or "(*b*) Transition," under which mutual thrift institutions would be allowed a "true" bad-debt reserve and in addition would be allowed to deduct for tax purposes a diminishing percentage of any additional retained earnings over a 2-year or a 4-year period of transition. The first alternative (*a*) would produce more revenue immediately than would H.R. 10650. The second alternative (*b*), at the end of the transition period, would provide the same revenue as alternative (*a*). Depending on the length of the transition period, there would be a year or two when (*b*) would produce less revenue than H.R. 10650, but only for a short period.

The Bankers Committee for Tax Equality also wishes to point out the fact that the bill now before you, as well as Secretary Dillon's latest recommendation, would permit each mutual savings institution to decide every year which formula would result in its paying the least taxes. Government revenue would suffer accordingly.

Mr. Chairman, on the issue of tax equality, the five national organizations of the commercial banking industry join with President Kennedy, who said in his budget message—

> the tax-deductible reserve provisions applicable to mutual savings banks and savings and loan associations should be amended to assure nondiscriminatory taxation among competing financial institutions.

Having no desire to harm either the savings and loan associations or the mutual savings banks, we would not want more. Knowing our country's need for revenue, we see no valid reason for stopping short of the goal the President has set.

We thank you, Mr. Chairman, and members of the Senate Finance Committee, for this opportunity to appear today.

The CHAIRMAN. Thank you, Mr. Tark.

Senator Douglas.

Senator DOUGLAS. Mr. Chairman, I have known Mr. Tark as a very able banker in Chicago. I was interested in many features of his testimony, but I was impressed with the fact that he spent all of his time discussing the taxes which the savings and loan associations and the mutual savings banks should pay, and he did not touch on the subject of withholding, whereas this morning the American Bankers Association spent a good deal of its time on the subject of the 20-percent withholding taxes.

Is that accidential, Mr. Tark, or do you have opinions on the subject?

Mr. TARK. I have a very decided opinion, Senator Douglas.

Senator DOUGLAS. I would be very glad if you would now share your opinions with us. You have kept them under a bushel thus far.

Mr. TARK. I had no intention of speaking on the subject of withholding, frankly, because I am not opposed to it.

Senator DOUGLAS. Pardon?

Mr. TARK. I am not opposed to withholding.

Senator DOUGLAS. You are not opposed to withholding?

Mr. TARK. No. I did not intend to speak on it particularly in view of the fact that I had only 15 or 20 minutes, and I thought time was so limited.

Senator DOUGLAS. If you are not opposed to it, are you in favor of it?

Mr. TARK. You have given me that opportunity, if I may go on.

Senator DOUGLAS. Certainly. This is both unusual and very welcome.

Mr. TARK. I wrote out my answer in case one of you gentlemen asked a question. May I read it to you?

Like the representatives of the commercial banks, the savings and loans and mutual banks, I, too, support the basic premise that all taxable income should be reported and paid. They all say that. However——

Senator DOUGLAS. Then they say "but."

Mr. TARK. However, whereas they find many objections to withholding, such as describing withholding as impractical, confusing, irritating, and imposing unreasonable hardships and inequities on widows, orphans and the tax-exempt institutions, and imposing an undue burden and expense upon banks and others, whereas that is their viewpoint after their basic agreement with the principle, I, on the other hand, prefer to think of this problem from another viewpoint.

I do not deny that there will be some inequities and injustices. Nor do I dispute that there will be burdens imposed upon the payers.

I hope they will be kept to an absolute minimum. What concerns me more is the basic facts that taxes should be levied fairly, honestly, and without discrimination or favoritism, and that taxes should be reported and paid by all alike.

Obviously, if a large segment can and do escape their responsibility, others may justifiably rationalize that they are being victimized when they pay their taxes in full.

Withholding does not impose a new tax liability where one does not already exist. It is merely a mechanism of collection. Almost 100 percent of the people who will be affected by withholding are already liable for the payment of taxes.

Comparatively speaking, only a small segment will not be liable for the payment of taxes withheld, and it is this little group that will be inconvenienced and probably some of them will be hurt.

Those who oppose withholding emphasize that some people will be hurt, and by so doing they have created an antagonism and an opposition to the whole idea of withholding.

I prefer to stress that withholding is a means of collecting taxes from those who do not and would not otherwise pay them, and essentially this law operates in a spirit of fairness to the large bulk of Americans who do pay their taxes honestly.

I have appeared before you today submitting that the net incomes of savings and loan associations and mutual banks should be taxed similarly to that of banks and other financial institutions.

It would be inconsistent and inequitable for me to urge you to adopt legislation looking to the collection of taxes from a group that are presently unfairly exempt from the payment thereof and, at the same time, contend that I am opposed to legislation which is aimed at collecting of taxes from those who are presently liable therefor but are not paying them.

If everyone reported and paid his tax on interest and dividend income, there would be no necessity for this legislation. However, unfortunately, we know that this is not so.

Hence legislation which is, to a degree, burdensome and obnoxious must be passed to enforce collection of taxes from those who are less than completely honest. Very likely, your committee will find ways to simplify the withholding procedure and make it the least burdensome possible.

However, I think the withholding section of the tax bill, procedurally improved, if possible, should be passed, so taxes can be collected starting with 1963, and not be deferred for several years or indefinitely.

Does that answer your question, Senator Douglas?

Senator DOUGLAS. I want to congratulate you upon that statement. I hope that copies of it may be circulated to all the members of the American Bankers' Association so that they may read it in the morning.

I would like to ask is this statement simply submitted by you individually or do you speak for the Bankers' Committee for Tax Equality?

Mr. TARK. That is the position of the executive committee of Bankers' Committee for Tax Equality and of myself, personally.

Senator DOUGLAS. So I understand you to say that the Bankers' Committee for Tax Equality takes this position?

Mr. TARK. Yes, that is right. That is the position of the Bankers' Committee for Tax Equality as adopted by the executive committee. We so testified last May, I think, or August, some time last year before the Ways and Means Committee. A letter went forth to all of our membership telling them that I was going to so testify.

Senator DOUGLAS. Did they object?

Mr. TARK. Oh, we might have had a handful of letters objecting. [Laughter.]

I want to make this clear, Senator. You asked me did they object. What I say will not make me popular with some of the bankers in back of me, nor will it make me popular with the mutual savings bankers.

Senator DOUGLAS. It makes you very popular with the American people, Mr. Tark.

Mr. TARK. I hope that will be recognized. When spokesmen come before you and sit here and say to you "I speak for 80,000 members," "I speak for 100,000 members," to a great degree it is misleading. The big bulk of membership in every organization do not lead, they follow. The so-called leadership sets forth the policies, and then they go out and sell those ideas to their membership. They propagandize

them, and they publicize the ideas to them. For example, if you go out and tell the people how burdensome withholding is going to be and how terribly costly and expensive it is going to be, obviously those people out there in the grassroots are going to answer you back and agree that it is burdensome.

We wrote this letter I have referred to before telling them we, the members of the executive committee, were going to support withholding. We cannot see how we can conscientiously ask for tax equality vis-a-vis the savings and loan and mutual savings banks and, simultaneously, say to you, "But, no, don't you affect us in any way; don't you put a burden upon us; we will not assist you in collecting a billion dollars of taxes that are going down the drain right now."

Last year I went around the country making talks on tax equality at various bankers' conventions and conferences, and so on, I had the question put to me "Why are you for withholding?" And when I explained to them how the Treasury told us the mechanics of withholding would work, in many instances almost 100 percent of the fears which they had when they asked the question were dispelled.

I have no doubt there is going to be some burden, but I think that is up to you gentlemen of the committee and the Treasury Department to make it as smoothly operated as possible.

I will tell you what is going to make it a lot more difficult. The original scheme of things advanced in the discussion on withholding last year, called for a flat 20 percent to be withheld from the amount of interest we would pay. It was a very simple thing to do that.

Senator DOUGLAS. With no listing of individual names.

Mr. TARK. No listing or reporting of names.

Senator DOUGLAS. Or addresses or amounts deducted?

Mr. TARK. None of that at all. We did not talk particularly about exemption certificates on the theory that it would be up to the Treasury Department to put into effect an effective and efficient refund system.

Senator DOUGLAS. In other words, there was no provision for exemption of those over 65 or those under 18.

Mr. TARK. None at all. It was not in there. That original system provided for a very easy method of doing it.

Then, along came the objection to the whole idea of withholding. Some of those who objected started to stress the sympathy approach, and I do not blame them. Then came along people like myself who are over 65 years of age, and who many feel should be given breaks because they need them so badly, so they were given the right to file an exemption certificate. Those under 18, and others are now allowed exemption certificates, making it burdensome.

Senator DOUGLAS. Did not many of the banks urge that these exemptions be granted?

Mr. TARK. Yes, no question about it.

Senator DOUGLAS. Now that the exemptions have been granted at their request they claim this would cause too great an administrative burden on them.

Mr. TARK. I agree with you on that, even though I make myself very unpopular.

The CHAIRMAN. Mr. Tark, were the membership of the Bankers' Committee for Tax Equality—how many members have they got?

Mr. TARK. Approximately 6,000, Mr. Chairman.

The CHAIRMAN. How many bankers?

Mr. TARK. What is that?

The CHAIRMAN. Of the total number of bankers.

Mr. TARK. I would say in the United States it is between 14,000 and 15,000. There is a great overlapping, Mr. Chairman. The people who are our members may also be members of ABA and of the IBA. There is an overlapping because ABA will testify they represent 13,000 or 14,000; IBA, about 6,000, and our Bankers' Committee for Tax Equality about 6,000. There are of course not as many bankers in the United States as the total represents.

The CHAIRMAN. Did this expression come from a referendum to 6,000 bankers?

Mr. TARK. No. We are essentially a committee, not an association. We determine our membership by those who send in checks to support our program. They are contributing members.

The CHAIRMAN. What I am trying to get at is how many bankers voted in favor of the withholding plan?

Mr. TARK. We did not ask them that question. We told them that the members of their executive committee were favoring withholding [laughter] this may sound laughable, Mr. Chairman.

The CHAIRMAN. How could you speak for them then if you did not ask them?

Mr. TARK. Mr. Chairman, the remarks I made a moment ago that the other banking organizations do not have letters from all their members on every position they take, either. Our officers adopted the leadership viewpoint—we each reported back to our members that we were going to testify in favor of withholding. They can write in protest or resign if they do not like it. That is their privilege, and I say to you, Mr. Chairman, that our executive committee is speaking effectively for the bankers who are members of the Bankers' Committee for Tax Equality. Senator Douglas, on our committee of the Bankers' Committee for Tax Equality, they are not all little fellows like myself. Mr. Howard J. Stoddard who just now testified, and Mr. Arthur Roth, whom he mentioned, are members of our committee.

Senator DOUGLAS. Are they present in the room?

Mr. TARK. Yes.

Senator DOUGLAS. Are they present in the room?

Mr. TARK. Yes, sir, Mr. Roth and Mr. Stoddard.

Senator DOUGLAS. You agree with Mr. Tark's testimony on withholding?

Mr. ROTH. Yes, we do agree, and Franklin National is going to appear before this committee as an individual bank next week and say we are in favor of withholding.

Senator DOUGLAS. Mr. Stoddard?

Mr. STODDARD. I would like to read in the record, if I might, a statement that our bank released, June 1, 1961, a copy of which was sent to the president of every bank in the United States. We first covered the desirability of taxing savings and loans. After that we quoted another portion of the President's message, indicating the possibility

of an increase in revenue of no less than $600 million by withholding of interest and dividends.

I recommend the enactment of legislation to provide a 20-percent withholding rate on corporate dividends and tax-investment-type interest, effective January 1, 1962, under a system which would not require the preparation of withholding statements to be sent to the recipients.

Then the Michigan National Bank wrote:

We believe favorable congressional action on these two recommendations should be taken at the same time. As bankers advocating a program to close tax "loopholes," we cannot, in good conscience, ask for favorable treatment of the first recommendation without also supporting the second. If withholding is broadly applied to all dividends and interest, it will not create any infavored investment medium and disturb the normal growth of savings deposits.

Senator DOUGLAS. I want to congratulate you, Mr. Stoddard, and I am glad that this supplement to your testimony has been brought forward.

(The document referred to follows:)

MICHIGAN NATIONAL BANK,
Lansing, Mich., June 1, 1961.

To the Presidents, All Commercial Banks in the United States.

GENTLEMEN: President Kennedy, in his tax message to Congress on April 20, recommended, among other things, the correction of structural defects in the present tax laws. One of the most glaring has been the inequality of taxation which has existed between commercial banks, savings and loan associations, and mutual savings banks, as shown by the following 10-year statement (in millions):

10-year period 1951-60	Taxable income	Federal taxes	Percent
Insured commercial banks	$22,237	$9,066	40.8
Insured mutual savings banks	1,223	10	.8
All savings and loan associations	3,760	47	1.3

The President's message, without indicating the actual additional Federal revenue which would be received (estimated at $300 million) covered the situation as follows:

"Some of the most important types of private savings and lending instiutions in the country are accorded tax-deductible reserve provisions, which substantially reduce or eliminate their Federal income tax liability. These provisions should be reviewed with the aim of assuring nondiscriminatory treatment. Remedial legislation in these fields would enlarge the revenues and contribute to a fair and sound tax structure."

Another portion of the President's message, indicating an increase of no less than $600 million by withholding of interest and dividends, was as follows:

"I recommend the enactment of legislation to provide a 20-percent withholding rate on corporate dividends and taxable investment-type interest, effective January 1, 1962, under a system which would not require the preparation of withholding statements to be sent to the recipients."

We believe favorable congressional action on these two recommendations should be taken at the same time. As bankers advocating a program to close tax "loopholes," we cannot, in good conscience, ask for favorable treatment of the first recommendation without also supporting the second. If withholding is broadly applied to all dividends and interest, it will not create any favored investment medium and disturb the normal growth of savings deposits.

Sincerely yours,

HOWARD J. STODDARD, *President.*

Statements of all insured commercial banks in the United States

[In millions of dollars—at yearend]

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
ASSETS										
Cash and due from banks	44,242	44,299	44,478	43,235	46,560	48,438	48,219	48,792	49,211	51,902
U.S. securities	60,599	62,408	62,473	68,121	60,877	57,947	57,686	65,789	58,391	60,522
Total cash and Governments	104,841	106,707	106,951	111,356	107,437	106,385	105,905	114,581	107,602	112,424
Other securities	13,074	13,873	14,370	16,021	16,364	15,987	17,644	20,267	20,192	20,498
Loans and discounts	58,185	64,728	68,228	71,412	83,027	91,692	95,577	100,087	112,866	119,878
Bank buildings and real estate	1,315	1,414	1,520	1,647	1,854	2,070	2,315	2,572	2,901	3,205
Other assets	848	864	946	1,223	1,130	1,542	1,869	1,921	2,033	2,674
Total assets	178,263	187,586	192,024	201,659	210,412	217,676	223,310	239,428	245,594	258,679
LIABILITIES										
Commercial deposits	127,116	132,562	133,599	139,033	145,098	148,370	147,160	155,599	156,314	162,159
Savings deposits	36,056	38,795	41,484	44,276	45,891	48,109	53,325	59,570	62,697	66,834
Total deposits	163,172	171,357	175,083	183,309	190,989	196,479	200,485	215,169	219,011	228,993
Other liabilities	2,354	2,740	2,715	3,000	3,147	3,618	3,963	4,113	5,180	6,671
Capital stock	3,699	3,876	4,030	4,287	4,567	4,872	5,169	5,418	5,861	6,208
Surplus	5,504	5,938	6,284	6,857	7,209	7,759	8,242	8,789	9,276	9,916
Undivided profits	2,259	2,307	2,498	2,653	2,776	2,940	3,232	3,457	3,633	4,021
Reserves	1,275	1,368	1,414	1,553	1,724	2,008	2,219	2,482	2,633	2,870
Capital funds	12,737	13,489	14,226	15,350	16,276	17,579	18,862	20,146	21,403	23,015
Total liabilities	178,263	187,586	192,024	201,659	210,412	217,676	223,310	239,428	245,594	258,679

NOTE.—(*a*) Loans and discounts are gross before deducting valuation reserves of $2,356,000,000 for 1960 and reserves are increased by this amount. (*b*) Statement does not include insured mutual savings banks with deposits of $31,000,000,000.

Earnings of all insured commercial banks in the United States

[In millions of dollars]

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
Interest on securities	1,233	1,376	1,505	1,598	1,685	1,713	1,855	2,046	2,278	2,370
Interest on loans	2,425	2,784	3,156	3,263	3,697	4,413	4,963	5,141	5,969	6,807
Other income	737	772	823	913	996	1,106	1,232	1,314	1,422	1,547
Operating income	4,395	4,932	5,484	5,774	6,378	7,232	8,050	8,501	9,669	10,724
Interest on time deposits	385	458	535	618	678	806	1,141	1,381	1,580	1,785
Salaries	1,350	1,495	1,652	1,762	1,896	2,093	2,268	2,400	2,577	2,798
Other expense	995	1,076	1,189	1,258	1,386	1,558	1,710	1,832	2,107	2,350
Operating expense	2,730	3,029	3,376	3,638	3,960	4,457	5,119	5,613	6,264	6,933
Operating profit	1,665	1,903	2,108	2,136	2,418	2,775	2,931	2,888	3,405	3,791
Nonoperating income [1]	−226	−218	−296	79	−468	−744	−559	85	−1,032	−404
Gross profit	1,439	1,685	1,812	2,215	1,950	2,031	2,372	2,973	2,373	3,387
Income taxes	531	695	786	908	794	814	998	1,271	885	1,384
Net profit	908	990	1,026	1,307	1,156	1,217	1,374	1,702	1,488	2,003
Percent on capital funds [2]	7.4	7.5	7.4	8.8	7.3	7.2	7.5	8.7	7.2	9.0
Dividends	419	442	474	517	566	617	678	726	776	832
Percent on capital funds [2]	3.4	3.4	3.4	3.5	3.6	3.6	3.7	3.5	3.7	3.7
Addition to capital funds	489	548	552	790	590	600	696	976	712	1,171
Number of banks	13,455	13,439	13,432	13,323	13,237	13,218	13,165	13,124	13,114	13,126

[1] Nonoperating income is the net between recoveries and losses, and includes transfers to and from various reserve accounts. The reserve method of accounting for losses in banks for Federal income tax purposes resulted in large transfers to reserve accounts for the years 1951 to 1960.

[2] See the following:

	Percent
Average earnings on capital funds for 10-year period	7.8
Average dividends on capital funds for 10-year period	3.6

Insured mutual savings banks

[In millions of dollars—At yearend]

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
ASSETS										
Cash	695	782	799	832	786	739	719	751	686	766
U. S. Government securities	6,921	6,593	6,476	6,117	5,858	5,518	5,404	5,215	5,016	4,786
Other securities	1,746	2,337	2,760	3,062	2,910	3,110	3,937	4,585	4,622	5,155
Mortgage loans [1]	7,688	8,845	10,179	11,826	13,753	15,736	17,393	19,387	21,148	24,069
Other assets	244	259	283	319	341	373	417	458	477	533
Total assets	17,294	18,766	20,497	22,156	23,648	25,476	27,870	30,396	31,949	35,309
LIABILITIES										
Total deposits	15,368	16,785	18,383	19,885	21,237	22,885	25,022	27,276	28,577	31,502
Other liabilities	83	96	133	176	215	267	340	440	512	592
Surplus accounts [1]	1,843	1,885	1,981	2,095	2,196	2,324	2,508	2,680	2,860	3,215
Total liabilities	17,294	18,766	20,497	22,156	23,648	25,476	27,870	30,396	31,949	35,309
Profit after dividends	119	79	98	108	110	123	126	140	170	150
Federal income taxes		2	2	3	1	1		1		
Net income retained	119	77	96	105	109	122	126	139	170	150
Number of banks	202	206	219	218	220	223	239	241	268	325
Percent increase in total assets	7	9	9	8	7	8	9	9	5	11

[1] Mortgage loans are gross before deducting valuation reserves of $217,000,000 for 1960 and surplus accounts are increased by this amount.

NOTE.—During 1960 noninsured banks with assets of $1,873 000,000 became insured banks.

	Millions
Net profit after dividends for 10-year period	$1,223
Federal income tax for 10-year period	10
Net income retained for 10-year period	1,213

All savings and loan associations

[In millions of dollars—at yearend]

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
ASSETS										
Cash	1,082	1,306	1,500	1,962	2,085	2,116	2,163	2,571	2,189	2,715
U.S. Government securities	1,606	1,791	1,923	2,005	2,319	2,743	3,154	3,785	4,471	4,586
Mortgage loans	15,610	18,416	21,957	26,088	31,354	35,719	39,969	45,478	53,087	60,084
Other assets	866	1,072	1,258	1,453	1,775	2,203	2,767	3,144	3,725	4,104
Total assets	19,164	22,585	26,638	31,508	37,533	42,781	48,053	54,978	63,472	71,489
LIABILITIES										
Borrowed money	884	934	1,014	932	1,522	1,343	1,373	1,427	2,134	2,191
Other liabilities	754	852	951	1,232	1,419	1,353	1,503	1,861	2,403	2,162
Capital shares	16,073	19,143	22,778	27,164	32,058	37,073	41,856	47,894	54,548	62,154
Profits and reserves	1,453	1,656	1,895	2,180	2,534	3,012	3,321	3,796	4,387	4,982
Total liabilities	19,164	22,585	26,638	31,508	37,533	42,781	48,053	54,978	63,472	71,489
Profit after dividends	184	206	244	291	360	483	313	481	597	601
Federal income taxes	....	3	5	6	6	5	4	6	6	6
Net income retained [1]	184	203	239	285	354	478	309	475	591	595
Number of associations	5,995	6,004	6,012	6,037	6,071	6,136	6,169	6,208	6,230	6,276
Percent increase in total assets	14	18	18	18	19	14	12	14	15	13

[1] Net income retained represents increas in "Profits and Reserves."

Total profit after dividends for 10-year period	3,760
Federal income tax for 10-year period	47
Net income retained for 10-year period	3,713

Growth of savings which public regard as available on demand

[In millions of dollars]

Year	All commercial banks	All mutual savings banks	All savings and loan associations	Credit unions	U.S. savings bonds	Postal savings	Total
1950	35,200	20,002	13,992	901	49,600	3,035	122,730
1951	36,592	20,880	16,107	1,082	49,100	2,808	126,569
1952	39,331	22,578	19,195	1,356	49,100	2,650	134,210
1953	42,001	24,345	22,846	1,691	49,400	2,466	142,749
1954	44,746	26,285	27,252	2,022	49,900	2,240	152,445
1955	46,331	28,113	32,142	2,447	50,300	1,990	161,323
1956	48,525	29,985	37,148	2,914	50,100	1,720	170,392
1957	53,751	31,652	41,912	3,382	48,200	1,401	180,298
1958	60,020	33,993	47,976	3,870	47,700	1,212	194,771
1959	62,949	34,934	54,583	4,438	45,900	1,016	203,820
1960	67,500	36,290	62,154	4,950	45,702	836	217,432
10-year growth	+32,300	+16,288	+48,162	+4,049	−3,898	−2,199	+94,702

The Harrison-Curtis Bills

(H.R. 2899–2900)

Two identical bills seeking tax equality between commercial banks, mutual savings banks, and savings and loan associations have been introduced in Congress by Representative Burr P. Harrison of Virginia, and Representative Thomas B. Curtis of Missouri.

Commercial banks, since the enactment of the Federal income tax law in 1913, have been subject to its provisions, and like all comparable business enterprises pay the regular rates on taxable income.

Mutual savings banks and savings and loan associations were exempt from Federal income taxes until 1951. Congress by that time had determined that they were no longer "mutual societies of poor people to acquire small homes." As a result, they were made subject to income taxes and revenues of $150 million were anticipated for 1952. Actually, only $5 million was received by the U.S. Treasury.

The reason for this lesser amount was that a conference committee amendment, never the subject of formal debate, permitted the establishment of a loss reserve up to 12 percent of their deposit or share accounts, on a tax-free basis. This completely nullified the original congressional intent. The reserve provision permitted practically all earnings to be diverted to reserves, thus depriving the Treasury of an estimated $2 billion in taxes since 1952.

The Commissioner of Internal Revenue permits commercial banks to establish a tax-free loss reserve based upon actual experience over a 20-year period. This reserve is based upon "risk assets," not deposits, and averages about 2½ percent. There is no justification for any difference in reserve formulas between the three types of financial institutions.

The Senate Report No. 781 in 1951 clearly recognized this situation when it stated, "so long as they are exempt from income tax, mutual savings banks and savings and loan associations enjoy the advantage of being able to finance their growth out of earnings without incurring the tax liabilities paid by ordinary corporations when they undertake to expand through the use of their own reserves. The tax treatment provided by your committee would place mutuals on a parity with their competitors."

The Harrison-Curtis bills now pending before Congress would eliminate this 12-percent reserve for loss provision, and require the mutual savings banks and savings and loan associations, like commercial banks, to obtain from the Treasury Department only that tax-free loss reserve on risk assets which is justified by actual experience. It is estimated that if this is done, the U.S. Treasury will receive approximately $300 million annually in additional taxes.

On the other hand, an objective study of the 10-year growth trend of commercial banks, mutual savings banks, and savings and loan associations discloses that unless this tax injustice is corrected, there will be a serious deterioration in America's fine commercial banking system.

Comparison with your bank

	Insured commercial banks	Percent	Your bank	Percent
ASSETS				
Cash	$51,902	20.06		
U.S. securities	60,522	23.40		
U.S. guaranteed loans[1]	7,267	2.81		
Risk free assets	119,691	46.27		
Other securities	20,498	7.92		
Loans and discounts	112,611	43.54		
Bank building and real estate	3,205	1.24		
Other assets	2,674	1.03		
Risk assets	138,938	53.73		
Total assets	258,679	100.00		
LIABILITIES				
Commercial deposits	162,159	62.69		
Savings deposits	66,834	25.83		
Total deposits	228,993	88.52		
Other liabilities	6,671	2.58		
Capital	6,208	2.40		
Surplus	9,916	3.83		
Undivided profits	4,021	1.56		
Reserves	2,870	1.11		
Capital funds	23,015	8.90		
Total liabilities	258,679	100.00		
Percent—Capital funds to risk assets		16.56		
EARNINGS				
Income on loans		5.85		
Income on securities		2.97		
Net income on total assets		.79		
Net income on capital funds		9.02		
Dividends on capital funds		3.75		

[1] U.S. guaranteed loans include all FHA mortgages and 50 percent of GI mortgages. Banks in making comparison should also give consideration to guaranteed portions of V loans, FHA title I and loans secured by Government bonds, as risk free assets. In this statement, Valuation reserve for losses on loans of $2,356,000,000 is not deducted from loans, but it is included in reserves.

Senator DOUGLAS. I think this is going to do a great deal to improve the image of bankers before the American public.

The CHAIRMAN. All I am asking, Mr. Tark, is simply for information and I do not think I have gotten it yet. I have not yet taken any position with respect to this matter and I have gotten a great many letters, hundreds, some thousands of them as chairman of this committee, and nearly all of them are opposed to the withholding.

How many bankers do you definitely speak for when you say that your organization is in favor of the withholding?

Mr. TARK. Mr. Chairman, we did not take a poll of that. Incidentally, we did not ask our member banks to write you letters telling you they favored withholding, either.

The CHAIRMAN. But you have not answered my question.

Mr. TARK. I do not know the answer. We took no poll.

The CHAIRMAN. You were speaking for what is known as the Bankers Committee for Tax Equality. Frankly, I have never heard of it. I do not say you are not a fine organization, but I would like to know when you say you speak for them, how many of your membership have requested you to speak to this committee in favor of bank withholding?

Mr. TARK. We did not ask them to vote on it, we did not ask them to write you letters.

The CHAIRMAN. How can you say then, that this Bankers Committee for Tax Equality is for this if you did not communicate with them?

Mr. TARK. Because we are set up as the executive committee, of this Bankers Committee for Tax Equality. We operate similarly as a board of directors and as trustees. We set forth the policies.

The CHAIRMAN. Then you did not communicate with the other 6,000 bankers?

Mr. TARK. We did communicate with them. We wrote that we, the executive committee, were going to support withholding and of the letters that went out, 6,000, only a handful responded saying, "We are opposed to this." We had another handful saying "More strength to you," but we did not attempt to make a statistical survey.

The CHAIRMAN. You are saying to this committee, then, that these 6,000 members favor withholding?

Mr. TARK. I would not dare say that 6,000 members favor withholding, any more so than the IBA, the ABA, or the Mutual Savings Bank Association can say that every member of theirs is opposed to withholding. Neither one of us can say actually how many people were for or against.

The CHAIRMAN. I am not criticizing anybody, but we sit on this committee. We represent the people of the United States. I, for one, so far as I am able to do it, desire to follow the wishes of the people if it is possible to do it. Frequently, we cannot do it because there is conflict of interest or conflict of opinion. I do not yet understand how many bankers you definitely speak affirmatively for in favor of withholding.

Mr. TARK. I shall answer as I did before, I do not know, because we did not ask them to vote and send in an affirmative letter saying "You are speaking for us on this matter of withholding."

The CHAIRMAN. But I must tell you again that you have testified that you are speaking for the Bankers Committee for Tax Equality.

Mr. TARK. That is right. When the banker members of the Bankers Committee receive notice of the position their excutive committee intends to take and then continue to support us by sending in their checks, they must be substantially in accord with our views.

The CHAIRMAN. You are a sincere man; I do not question that. Is it your judgment that the majority of these 6,000 bankers favor withholding?

Mr. TARK. It is my personal judgment. I go further and say this to you, that if it was clearly explained to them so that they really understood withholding, I think it would be far more than 75 percent who would support it.

The CHAIRMAN. Do you favor the exemptions in the House bill?

Mr. TARK. Do I favor what?

The CHAIRMAN. The exemptions on withholding. Do you favor the exemptions that were placed in the House bill as to those that would——

Mr. TARK. Over 65 and the 18?

The CHAIRMAN. That is right.

Mr. TARK. I think these are reasonable exemptions, but they have made the procedure on withholding tax more burdensome. But they are definitely within reason. I am not trying to tell this committee or the House committee how to word the bill. I am merely asking you to keep it procedurally as simple as you can. It can be worked out.

The CHAIRMAN. Well, you favor the House bill with exemptions, then, do you?

Mr. TARK. That is right.

The CHAIRMAN. Thank you very much.

Senator CURTIS. Mr. Chairman, may I ask a question?

The CHAIRMAN. Senator Curtis.

Senator CURTIS. Are you a member of the American Bankers Association?

Mr. TARK. Yes, sir.

Senator CURTIS. Are you a member of the Independent Bankers Association?

Mr. TARK. Yes, sir, I happen to be on their 45-man executive council.

Senator CURTIS. Does the American Bankers Association have periodic meetings of their membership?

Mr. TARK. Yes, they have a big convention once a year, and they have their various divisional meetings periodically throughout the year.

Senator CURTIS. Is their legislative position discussed at those meetings?

Mr. TARK. I imagine so. I am not on their legislative committee.

Senator CURTIS. You have been at some of their meetings?

Mr. TARK. I have been invited to attend various of their meetings at their own offices here in Washington.

Senator CURTIS. I am talking about their membership meetings.

Mr. TARK. I do not recall many votes taken in their meetings. The only time I recall such a vote is when Mr. Roth's amendment came up seeking to disqualify mutual savings banks from membership in the ABA. They had a vote on that issue.

Senator CURTIS. By mail?

Mr. Tark. No, no, in person; only those present at the convention voted.

Senator CURTIS. Do the Independent Bankers Association have periodic meetings?

Mr. TARK. Yes, sir.

Senator CURTIS. Do they have annual meetings?

Mr. TARK. They have an annual meeting.

Senator CURTIS. How about your group of 6,000, do they have meetings?

Mr. TARK. No, we do not have convention meetings—we are more of a committee than an all-round association.

Senator CURTIS. Have the 6,000 ever been——

Mr. TARK. To a convention, to a meeting? No. Our contact with members is almost entirely by mail. We keep them informed as to what our thinking is on the executive committee; what we propose to do. And it is their privilege to write us their views in opposition or to

drop out of our organization at any time they choose to by just not sending us their contribution. It is as simple as all that.

Senator CURTIS. But the IBA, do have regularly scheduled meetings for communication with the members?

Mr. TARK. Yes, and, Senator Curtis, I think maybe I ought to explain something to you that will clarify this thing you are driving at.

The Bankers Committee for Tax Equality does not attempt to occupy the position of a trade association in the banking industry—am I speaking to Senator Curtis?

Senator CURTIS. Yes.

Mr. TARK. The bankers committee does not attempt to occupy a position in the banking industry which is occupied by the Independent Bankers Association and the ABA.

Thirteen or fourteen years ago, our committee was organized, first and foremost to seek tax equality. If and when Congress arrives at tax equality, we will go out of existence as a bankers committee.

Senator CURTIS. Now, this information that you sent to them stating that you were going to take a position for them in favor of withholding the tax on dividends and interest, was that a different letter to each of the 6,000 members?

Mr. TARK. Yes, I have one here I can show you.

Senator CURTIS. Would you insert it in the record?

Mr. TARK. Yes, I would be glad to.

Senator CURTIS. How many banks in Nebraska on the committee favor withholding of tax on dividends and interest?

Mr. TARK. I do not know positively how many of our members in Nebraska favor it.

Senator CURTIS. Do you know how many——

Mr. TARK. But I can tell you this, I can give you the numbers of bankers in the State of Nebraska who continued to make their contributions to this Bankers Committee after the mailing of that letter which notified them that the members of their executive committee intended to testify favoring withholding.

Senator CURTIS. Do you know any of them that do favor withholding on interest?

Mr. TARK. No, as I stated, I did not attempt to poll them, and I did not come here with letters that favor it. There are many bankers that favor it.

But, for the State of Nebraska or any other State, we can tell you exactly how many banks continue to contribute their support to this committee knowing that we would testify, as we did last year, for withholding.

Senator CURTIS. Do you not suppose that they regard the support of your committee as an expenditure for tax equality primarily?

Mr. TARK. I would say that that would be very complimentary.

Senator CURTIS. Is not that the idea that has been sold to them?

Mr. TARK. I do not know exactly what motivated them.

Senator BENNETT. Did you change the name of your committee to the Bankers Committee in Favor of Tax Equality and Withholding, or is it the same?

Mr. TARK. No, we are principally advocates of tax equality. We stated to them in the letter, as we stated here today, our opinion that we could not conscientiously contend for tax equality and stand op-

posed to tax withholding. We notified them we were going to so testify.

Senator BENNETT. Who are "we"?

Mr. TARK. The spokesmen for the Bankers Committee for Tax Equality. I appeared before your committee as far back as 1951.

Senator BENNETT. I understand that you are spokesman for them here, but you are one. When you say "we stated," how big a group met and decided that you were going to testify in favor of withholding?

Mr. TARK. Let me read this letter to you. The executive committee consisted then of R. E. Gormley, who is going to testify later today, Arthur T. Roth, Mr. Stoddard, and myself.

On the 20th of May of 1961, we wrote the following letter to our banker members:

> DEAR BANKER MEMBER AND FRIEND: On Friday, May 26, I shall appear as a witness before the Committee on Ways and Means in support of withholding the tax on dividends and interest. I shall do so as the executive head of the Main State Bank of Chicago, Ill. Mr. Howard Stoddard, president of the Michigan National Bank, will also appear. Mr. Arthur Roth of the Franklin National Bank, Long Island, will have his comptroller testify. After careful analysis and much thought each of us will support the Treasury recommendation on withholding.

This is a letter from me to them on this Bankers Committee stationery.

The CHAIRMAN. How many did that go to?

Mr. TARK. It went to about 6,000 members.

The CHAIRMAN. How many favorable replies did you receive?

Mr. TARK. We received only 50 or 60 replies altogether. I did not attempt to tabulate them.

The CHAIRMAN. Would you have any objection to putting those replies in the record?

Mr. TARK. Mr. Chairman, I am not a paid executive of a committee, I am a Chicago banker, and I actively——

The CHAIRMAN. You came here to testify to certain facts. I am not trying to embarrass you; I am trying to get the facts.

Mr. TARK. I realize that.

The CHAIRMAN. If the bankers want withholding, I would like to know it and if they are opposed to it, I would like to know it, and I shall make up my own opinion.

Now, if you sent letters to 6,000 bankers, I assume you got replies. If they have replied to that letter, I can see no objection to putting those replies into the record.

Mr. TARK. May I finish this letter?

The CHAIRMAN. Certainly. I thought you had finished.

Mr. TARK (reading):

> It is my firm conviction that the bankers of the country, the majority of whom wish tax equality, cannot consistently urge the House Committee on Ways and Means and the Treasury to adopt legislation to close this glaring loophole of tax favoritism for the mutual savings banks and savings and loans and at the same time oppose the closing of another loophole of even greater magnitude. In short, I believe that our support of withholding is necessary if we are to preserve the integrity of our position.
>
> It was in this context that the executive committee of the Bankers Committee on Tax Equality, by a vote of 3 to 1, directed that this organization recommend to the bankers of the country that they support the Treasury in its program of tax witholding on dividends and interest.

Messrs. Roth and Stoddard, and I, have had a number of conferences with Treasury officials. Attached is a copy of an exchange of letters between the Honorable Stanley S. Surrey, Assistant Secretary of the Treasury, and myself. You will undoubtedly be interested in the Treasury's enclosure, presenting the most detailed analysis of the actual operation of withholding we have seen anywhere. I am convinced this is a simple and workable plan and urge the bankers of the country to support it.

Opponents of withholding have alleged there might be a loss of deposits in banking institutions if withholding of the tax on interest is enacted. I cannot agree with that viewpoint. In my judgment, deposits leaving one institution will have to go to another; and on balance, the banks will gain. I realize that there will be some expense and additional work incurred by the banks of the country, but considering the principles involved, including the closing of the savings and loan and mutual savings bank loophole, I personally believe we have no real alternative but to support the Treasury recommendation on withholding.

It has been estimated that eliminating the tax favoritism to savings and loan and mutual banks will bring to the Treasury additional revenue of approximately $300 million and that the enactment of withholding which closes the interest and dividend loophole will result in additional revenue of $600 to $900 million. In this day of world conflict, high defense expenditures, and domestic problems, these sums will help our country materially.

Sincerely.

Senator BENNETT. Mr. Chairman, it seems to me that Mr. Tark is talking for four people, three of whom agree and one who disagreed, but not for 6,000 people as his statement alleges.

Is that a fair statement?

Mr. TARK. No, I do not think it is.

The CHAIRMAN. I imagine Mr. Tark must have gotten some replies.

Mr. TARK. We did. Fifty or sixty.

The CHAIRMAN. This is a very heated question. Would you object to supplying the committee with some of those replies?

Mr. TARK. No, I have no objection. We shall supply them.

The CHAIRMAN. Would you put them in the record?

Mr. TARK. Yes. What I do when I get these replies in my bank office in Chicago, they all go into a general file, and I have a space as large as your platform full of letters from all over the country during this entire period of 13 or 14 years. I do not attempt to run an association out of my bank's office in Chicago. I have no secretaries or employees running this for me. I have nothing to do with running the Bankers Committee office here in Washington except as a member of the executive committee.

The CHAIRMAN. You do not seem to understand what I said. You speak for this committee.

Mr. TARK. I certainly do.

The CHAIRMAN. This committee is composed of 6,000 bankers. I want to know if you speak for yourself, for this executive council of 4, or for the 6,000 bankers?

Mr. TARK. We shall attempt to dig out the letters we got in the way of responses. But I also want to put in the record my own humble opinion that I speak as much for our committee's membership as any spokesman for an association who appears before you, today.

The CHAIRMAN. I understand that. But I want to know if you appear here representing a certain number of bankers.

Mr. TARK. We shall submit the replies you asked for.

(The letters referred to follow:)

BANKERS COMMITTEE FOR TAX EQUALITY

Suite 300 • 1000 Connecticut Avenue Building • Washington 6, D.C. • EXecutive 3-0545

Co-Chairmen
L. SHIRLEY TARK, President, Main State Bank, Chicago, Illinois
AUBREY E. AUSTIN, JR., President, Santa Monica Bank, Santa Monica, California
F. H. CHILCOTE, President, The Farmers & Stockmens Bank, Clayton, New Mexico
E. E. GORMLEY, Vice President, Georgia Savings Bank & Trust Co., Atlanta, Georgia
ARTHUR T. ROTH, Chairman of the Board, The Franklin National Bank of Long Island, Franklin Square, New York
HOWARD J. STODDARD, President, Michigan National Bank, Lansing, Michigan

G. M. BAZEMORE, President [illegible]
H. C. BROWN, President, The First National Bank of Glens Falls, Glens Falls, New York
E. R. CAMPBELL, President [illegible]
WM. C. CLARY, JR., President [illegible]
R. E. CLAYPOOL, President, The Merchants National Bank, Montgomery, West Virginia
J. P. CULPEPPER, Executive Vice President [illegible]
F. C. FERGUSON, President [illegible], Jersey City, New Jersey
LEIGHTON HOUGH, President [illegible]
O. B. LARSEN, Vice President [illegible], California
W. F. MEBURG, President [illegible]
A. C. MELONEY, President [illegible]
R. W. OSTERMAN, President, Rock Island Bank & Trust Co., Rock Island, Illinois
[illegible], President [illegible], Virginia
W. W. SHAPARD, President [illegible], Virginia
ALLEN H. SIMS, Executive Vice President, The Citizens National Bank [illegible], North Carolina
T. ALLAN SMITH, Vice President, Bank of the Commonwealth, Detroit, Michigan
RICHARD W. SNOOKS, President [illegible]
G. W. THOROGOOD, President [illegible], Tennessee
M. E. WEIMER, President [illegible], Wisconsin
WILLIS D. WYARD, President, First and American National Bank of Duluth, Duluth, Minnesota

Executive Committee
E. E. GORMLEY
ARTHUR T. ROTH
H. J. STODDARD
L. SHIRLEY TARK
Secretary
VERNON SCOTT

May 20, 1961

Dear Banker Member and Friend:

On Friday, May 26, I shall appear as a witness before the Committee on Ways and Means in support of withholding the tax on dividends and interest. I shall do so as the executive head of the Main State Bank of Chicago, Illinois. Mr. Howard Stoddard, president of the Michigan National Bank, will also appear. Mr. Arthur Roth of the Franklin National Bank, Long Island, will have his comptroller testify. After careful analysis and much thought, each of us will support the Treasury recommendation on withholding.

It is my firm conviction that the bankers of the country, the majority of whom wish tax equality, cannot consistently urge the House Committee on Ways and Means and the Treasury to adopt legislation to close this glaring loophole of tax favoritism for the mutual savings banks and savings and loans and at the same time oppose the closing of another loophole of even greater magnitude. In short, I believe that our support of withholding is necessary if we are to preserve the integrity of our position.

It was in this context that the Executive Committee of the Bankers Committee on Tax Equality, by a vote of three to one, directed that this organization recommend to the bankers of the country that they support the Treasury in its program of tax withholding on dividends and interest.

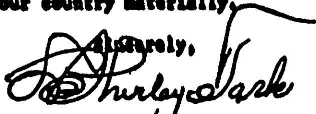
Messrs. Roth and Stoddard, and I, have had a number of conferences with Treasury officials. Attached is a copy of an exchange of letters between the Honorable Stanley S. Surrey, Assistant Secretary of the Treasury, and myself. You will undoubtedly be interested in the Treasury's enclosure, presenting the most detailed analysis of the actual operation of withholding we have seen anywhere. I am convinced this is a simple and workable plan and urge the bankers of the country to support it.

Opponents of withholding have alleged there might be a loss of deposits in banking institutions if withholding of the tax on interest is enacted. I cannot agree with that

viewpoint. In my judgment, deposits leaving one institution will have to go to another; and on balance, the banks will gain. I realize that there will be some expense and additional work incurred by the banks of the country, but considering the principles involved, including the closing of the savings and loan and mutual savings bank loophole, I personally believe we have no real alternative but to support the Treasury recommendation on withholding.

It has been estimated that eliminating the tax favoritism to savings and loan and mutual banks will bring to the Treasury additional revenue of approximately $300 million and that the enactment of withholding which closes the interest and dividend loophole will result in additional revenue of $600 million to $900 million. In this day of world conflict, high defense expenditures and domestic problems, these sums will help our country materially.

Sincerely,



LST:mb
Enclosures - 3

L. Shirley Tark
Co-Chairman

BANKERS COMMITTEE FOR TAX EQUALITY

Suite 300 • 1000 Connecticut Avenue Building • Washington 6, D.C. • EXecutive 3-0645

Co-Chairmen

L. SHIRLEY TARK, President
Main State Bank
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Santa Monica Bank
Santa Monica, California

F. H. CHICOTE, President
The Farmers & Stockmens Bank
Clayton, New Mexico

R. E. GORMLEY, Vice President
Georgia Savings Bank & Trust Co.
Atlanta, Georgia

ARTHUR T. ROTH, Chairman of the Board
The Franklin National Bank of Long Island
Franklin Square, New York

HOWARD J. STODDARD, President
Michigan National Bank
Lansing, Michigan

G. M. BAZEMORE, President
First National Bank
Waycross, Georgia

H. C. BROWN, President
The First National Bank of Glens Falls
Glens Falls, New York

E. R. CAMPBELL, President
Pioneer Bank & Trust Co.
Shreveport, Louisiana

WM. C. CLARY, JR., President
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Toccoa, Georgia

R. E. CLAYPOOL, President
The Merchants National Bank
Montgomery, West Virginia

J. P. CULPEPPER
Executive Vice President
Bank of Alapaha
Alapaha, Georgia

F. C. FERGUSON, President
Hudson County National Bank
Jersey City, New Jersey

LEIGHTON HOUGH, President
First National Bank in Oshkosh
Oshkosh, Wisconsin

O. R. LARSEN, Vice President
The Pajaro Valley National Bank
Watsonville, California

W. F. MEIBURG, President
Northwest Bank & Trust Co.
Davenport, Iowa

A. C. MELONEY, President
Security State Bank of Basin
Basin, Wyoming

R. W. OSTERMAN, President
Rock Island Bank & Trust Co.
Rock Island, Illinois

IRVIN REID, President
Citizens Marine Jefferson Bank
Newport News, Virginia

W. W. SHAPARD, President
Bank of Halifax
Halifax, Virginia

ALLEN H. SIMS
Executive Vice President
The Citizens National Bank
Gastonia, North Carolina

T. ALLAN SMITH, Vice President
Bank of the Commonwealth
Detroit, Michigan

RICHARD W. SNOOKS, President
Citizens Loan & Savings Company
St. Joseph, Missouri

G. W. THOROGOOD, President
Merchants Bank
120 Ocoee, N. E.
Cleveland, Tennessee

M. E. WEMER, President
Northwestern State Bank
Cumberland, Wisconsin

WILLIS D. WYARD, President
First and American National Bank of Duluth
Duluth, Minnesota

Executive Committee
R. E. GORMLEY
ARTHUR T. ROTH
H. J. STODDARD
L. SHIRLEY TARK

Secretary
VERNON SCOTT

May 12, 1961

COPY

The Honorable Stanley Surrey
Assistant Secretary
Department of the Treasury
Washington 25, D. C.

Dear Mr. Surrey:

I would appreciate receiving an outline of the modus operandi of withheld taxes as it applies to the payment of interest on savings accounts by commercial banks. Would you also explain the mechanics of claims for refunds by minors, by tax-exempt institutions, and others.

The procedure explained by your assistant, Mr. Rudney, seemed to be an uncomplicated one. I do hope that it will be possible to use the "refund draft." It would simplify this operation.

Though you and Mr. Rudney have fully informed me on the subject matter of withheld taxes on interest, for which I wish to express my appreciation, yet I would like to receive a written explanation so that I may in turn transmit this information to our member banks, as well as other banks throughout the country.

My thanks to you for the time and interviews you have granted to me and Messrs. Roth, Stoddard and Scott.

Most respectfully yours,

LST:mb

L. Shirley Tark
Co-Chairman

TREASURY DEPARTMENT,
Washington, May 17, 1961.

Mr. L. SHIRLEY TARK,
Cochairman, Bankers Committee for Tax Equality,
Washington, D.C.

DEAR MR. TARK: I welcome the opportunity you have given me in your letter of May 12 to provide you with a brief explanation of the system of withholding on interest and dividends proposed by President Kennedy in his tax message to the Congress on April 20. It occurs to me that some clarification of the subject may be of value. I believe that any apprehension over excessive burdens of withholding on the banks can be put to rest after careful consideration of the details of the proposal.

President Kennedy recommended interest and dividend withholding as a necessary step to recover more than $600 million of revenue lost annually because of nonreporting of interest and dividends and to eliminate an inequality in tax burden which is patently unfair to those who pay all of their taxes. The President pointed out that nonreporting of interest and dividend income had not been appreciably lessened by intensive educational programs. Nor can mass compliance be attained effectively and economically by audit procedures utilizing information returns.

On May 3, Treasury Secretary Dillon submitted the administration's withholding plan to the Congress. The Secretary pointed out that the withholding system is specifically designed to minimize the paperwork of payers of interest and dividends. Payers would have substantially less to do under the proposal than an employer does currently under wage withholding. For example, the payer would not be required to provide to interest and dividend recipients any withholding receipts, such as the W-2 form which now goes to wage earners. The payer would be asked to withhold on a simple flat rate basis without exemptions. Remittance to the Internal Revenue Service would be by lump sum without requiring the listing of individual payees as is now required under wage withholding. No additional information reporting to the Service would be required than is now required under existing law and regulations.

Secretary Dillon indicated that steps would be taken to alleviate any hardship on nontaxable institutions and individuals by withholding. Provision would be made to allow exempt institutions to offset currently the amounts withheld from their interest and dividends against the amounts they withheld from their employees for income and social security tax purposes. If this procedure is insufficient to provide a full offset, quarterly refunds would be provided.

Interest paid on school savings accounts would not be withheld on. This would eliminate overwithholding on more than 6 million children, almost all of whom are not subject to tax. However, if amounts were withheld from nontaxable minors in other situations, provision would be made for the parent of a dependent minor to claim credit on the parent's annual tax return for amounts withheld from the minor, if the parent so wishes. Individuals not subject to tax (other than minors) would be allowed to claim refunds on a quarterly basis. These refunds would be paid promptly.

Attached is an explanation of the withholding system, with illustrations of its applicability to savings account interest and savings bond interest.

As you know, we have worked closely with many banking and other groups in the development of the withholding system. Moreover, the banking community has more than demonstrated its public interest in working with the Treasury to achieve a workable withholding system which would be effective in meeting the nonreporting of interest and dividends. We appreciate very much their cooperation.

Sincerely yours,

STANLEY S. SURREY, *Assistant Secretary.*

[Treasury Department enclosure to letter dated May 17, 1961, from Assistant Secretary Surrey to Mr. Tark]

HOW WITHHOLDING WOULD OPERATE

It is proposed that withholding be made applicable to dividends, interest on savings accounts, interest on corporate bonds (registered and coupon), interest on U.S. Government obligations (registered, coupon, and savings bonds). For

practicable purposes it is desirable to exclude certain types of interest such as interest paid by individuals, Government discount bills, etc.

One general rate of withholding, 20 percent, would be prescribed. The withholding agent would be the ultimate payer of interest or dividends at source. Corporations (or their disbursing agents) would be the withholding agent on dividend payments. The U.S. Government and corporation would be the withholding agents on bond interest. Banks would act as intermediate payers of interest in the case of coupon interest and interest paid at redemption of savings bonds. The intermediate payers would not be withholding agents. Banks would simply pay coupon interest and savings bond interest on a net basis (80 percent of gross). The bank would in turn be credited on a net basis by the ultimate payers who would withhold tax. However, banks, as the ultimate payers, would be the withholding agents in the case of interest paid on savings accounts.

The withholding agents would not be required to keep records of tax withheld from each recipient, nor would the agent be required to provide withholding receipts to the recipients. The withholding agent would merely remit to the Internal Revenue Service 20 percent of the interest or dividends payable.

To account for the proper amount of interest on the tax return, the recipient would include the gross amount of interest or dividends in income and claim as a credit against tax liability the amount of tax withheld. For example, to account for the proper amount of interest to be reported, the recipient would make the following "gross up" computation with respect to interest on which amounts have been withheld: (1) the net amount of interest received after withholding; (2) the amount withheld, which at a 20-percent withholding rate would be exactly one-quarter of the net amount received; and (3) the sum of interest actually received and the amount withheld which is the gross amount subject to tax. This gross amount would be included in income, and the recipient would take credit against his final tax liability for the amount of tax withheld as he does for wage or salary withholding. The tax return would clearly indicate the steps to be taken and give the necessary guidance to the taxpayer.

DEPOSIT INTEREST

Banks, say paying quarterly 0.75 percent interest on deposits, would remit to the Internal Revenue Service 20 percent of total interest credited to deposit accounts for the quarter. If $1 million is credited, the Internal Revenue Service would receive $200,000. It would not be necessary for the bank to determine the total amount to be paid to the Government by adding up the amounts withheld from each individual.

The bank would credit each account at the rate of 0.6 percent quarterly. No receipt for tax withheld would be required for each depositor. In actual practice, the bank would not be required to make any additional computation for each account than it does today.

The depositor earning $100 gross interest on his savings for the year would be credited with $80 net after withholding. He would compute 25 percent of this amount or $20 to determine the tax withheld. The sum of $80 received and $20 withheld or $100 would be included in his adjusted gross income. After computing his total tax liability, he would deduct credits for the tax withheld on wages, payments on declaration of estimated tax, and the $20 withheld on interest. If there are taxes due he would remit the balance due with his return. If there is an overpayment, he would receive a refund.

The computations would be the same if the individual received interest from several sources. He would enter the net amounts received from these sources and would then "gross up" the total net receipts.

INTEREST ON U.S. SAVINGS BONDS

Banks and other agents authorized to redeem U.S. savings bonds would be provided with tables that would show the amount to be paid at redemption as at present. The net amounts will reflect 80 percent of interest earned up to redemption. Assume that an individual redeems a $50 bond at maturity which he purchased at $37.50. The amount of the interest included in that $50 would be $12.50, but the bank would pay the individual only 80 percent of that amount or $10. Thus, the bank would remit to him $47.50. The bank is a fiscal agent of the U.S. Treasury and would act in the same manner as an intermediate payer and, therefore, would not be the withholding agent. It would pay only the net amount of interest on the savings bond. The bank would recover this net amount from the U.S. Government. The Government would be the withholding agent

transferring funds to the Internal Revenue account when the redeemed bonds are recorded in the public debt account.

In the typical case, most individuals would not have entered the amount of interest from U.S. savings bonds on their annual returns as interest accrues. Consequently, the total interest paid in the year of redemption would ordinarily represent the correct amount of interest includible in taxable income in that year. In the relatively rare case where an individual accrued his interest annually, withholding at redemption would be based on the total amount of interest paid in the year of redemption. These few taxpayers would not include in income in the year of redemption the amount of interest entered on prior year returns. However, the full amount of tax withheld would be credited against his tax liability in the year of redemption.

MAY 17, 1961.

MAIN STATE BANK,
Chicago, Ill., April 17, 1962.

Hon. HARRY F. BYRD,
Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: When I testified before the Finance Committee last Wednesday you requested for insertion in the record some of the replies which I had received to the letter we mailed to approximately 6,000 subscribing members of the Bankers Committee for Tax Equality on the subject of withholding. As you will remember, this is the letter which informed them that the members of their executive committee intended to testify before the House Committee on Ways and Means in favor of withholding.

After a search, I have found just a few letters, although it seems to me we received some 55 or 60 replies altogether. It will be observed that opposition to withholding was expressed by these writers.

As I testified, this handful of replies from a mailing to nearly 6,000 members led us to believe that the bankers were much less opposed to the idea of withholding than we had anticipated. This response was one of the smallest we have secured from a mailing to this list. Only last month, nearly 700 of our members replied to a general mailing.

The fact still remains, however, as I tried to develop in my testimony, that bankers who oppose withholding are inclined to change their minds when they are more fully informed. I have found this to be true in speaking to banker groups. Since I returned from the hearings in Washington, I received phone calls from two bankers in Illinois—one from Sterling, and the other from Deerfield. Both of these gentlemen were strongly opposed to withholding at the start of our conversation. When I explained the contemplated methods and procedures of withholding, they saw the matter in a different light—and I enclose letters from each of these bankers stating their support for withholding. This bears out my testimony in response to a question, "I go further and say this to you, that if it was clearly explained to them so they really understood withholding, I think it would be far more than 75 percent that would support it."

May I express my appreciation, Senator Byrd, for your courtesy and that of your committee when I appeared before you on the issue of tax equality for competing financial institutions during which I discussed withholding. While I realize there is a tremendous amount of opposition to withholding, I felt it was my duty to explain to the committee that this opposition was not as deep rooted as I had originally been led to believe. Once the facts are in the bankers' hands, they seem more willing to accept withholding in the interest of securing revenue for the country and contemporaneously, a just solution to the problems created by tax inequality.

Sincerely,

L. SHIRLEY TARK.

P.S.—Enclosed are copies of letters referred to in the second paragraph above.

(The 12 letters submitted by Mr. Tark with this communication follow:)

MUNROE AND CHAMBLISS NATIONAL BANK,
Ocala, Fla., April 24, 1961.

Mr. L. SHIRLEY TARK,
Cochairman, Bankers Committee for Tax Equality,
Connecticut Avenue Building, Suite 500, Washington, D.C.

DEAR MR. TARK: We have read your letter of April 22, thoroughly, and understand that you are supporting a measure to require all banks to withhold tax on their savings interest which they pay to their customers.

If you know anything about the operation of an ordinary bank, you would certainly have more commonsense than to endorse a bill of this kind.

Yours very truly,

DEWITT GRIFFIN, *President.*

THE CITIZENS NATIONAL BANK,
Covington, Va., May 25, 1961.

Mr. L. SHIRLEY TARK,
Cochairman, Bankers Committee for Tax Equality,
1000 Connecticut Avenue, Washington, D.C.

DEAR MR. TARK: We appreciate the copy of your letter of May 12, 1961, addressed to the Honorable Stanley Surrey, and the attachments.

As I understand from your letter of May 20, 1961, your committee is recommending that we support the Treasury in the program of tax withholding on dividends and interest. This seems to be based on the premise that there will be legislation passed to close the glaring loophole of tax favoritism for the mutual savings banks and savings and loan associations. I would be particularly interested in knowing what assurance we have that this loophole will be closed.

Respectfully yours,

MORRIS H. HUDSON,
First Vice President.

CITY NATIONAL BANK & TRUST CO. OF ROCKFORD,
Rockford, Ill., May 27, 1961.

Mr. L. SHIRLEY TARK,
Cochairman, Bankers Committee for Tax Equality,
Main State Bank, Chicago, Ill.

DEAR MR. TARK: It was interesting to receive your recent letter regarding the two vital subjects of "Withholding on Interest and Dividends" and "Tax Equality." We compliment you on your presentation.

We understand that your position in this regard is due to your desire to evidence cooperation to further your desire to secure tax equality. However, nowhere in the information furnished on the subject, is there any indication that submission to withholding would secure tax equality. Of course, this could not be expected as it would be impossible to secure any commitment from Congress. Therefore, it would appear more sound to secure tax equality before submitting to a suggestion which, in our opinion, would work to the detriment and a hardship on your staff, your directors, your stockholders, and your customers.

We commend you on your efforts to secure tax equality which subject has been the point of effort of many organizations including your own. We believe that substantial progress has been made and therefore, we urge you to reconsider your present and contemplated stand and return to the original aim of your organization. We sincerely hope that you will reconsider and use your best efforts to defeat the withholding proposal.

Yours very truly,

CHARES SUMMERFIELD,
President and Trust Officer.

MAY 24, 1961.

Hon. A. S. HERLONG, Jr.
Member of Congress,
Washington, D.C.

DEAR SYD: I am writing to compliment you on your stand concerning the proposal of the administration for the tax treatment of dividend and interest income, and to urge you to stick to your guns in opposition to this legislation.

I was amazed to receive in this morning's mail information which indicated that some of my banker friends were not opposed to this legislation. I assure you these gentlemen represent a very small percentage of the banking industry.

It is my belief that some are being misled into thinking that the oversimplification of collecting this tax, as explained by the Treasury Department, will mean that banks will be put to little trouble and expense. Nothing could be further from the truth. I am convinced that if this legislation is enacted, banks will lose some of their savings accounts, and will be put to tremendous expense and inconvenience.

Again, I want to congratulate you for what some people call "intestinal fortitude." I think, "guts" is a better word, and if we had more men of your caliber in Congress, this country would be in much sounder condition.

Just remember when you open those several hundred griping letters each day, there are thousands of your constituents who admire your courage, but do not burden you with letters.

Kindest regards and best wishes for your continued success.

Sincerely,

HENRY C. COLEMAN.

THE CITIZENS BANK OF TIETON,
Tieton, Ga., May 25, 1961.

Mr. L. SHIRLEY TARK,
President, Main State Bank,
Chicago, Ill.

DEAR MR. TARK: We in the smaller country banks of Georgia are not very well versed in the tax equality movement that you and your committee are so diligently fighting for but we do believe in the basic thought—that of equality between commercial banks and the savings and loan institutions of our country.

In your recent letters concerning withholding taxes on savings accounts we are appalled at the idea of your committee favoring such a law by the Government. It is not our wish for our bank to become directly or indirectly responsible for the payment or collection of any individual or corporation income tax. We feel that regardless of the simplicity of the system, it will eventually become so engrossed by redtape that it would be undesirable to us as a collection agency and undesirable to our depositors.

If this is some type concession that we must make to the party in power, to receive the type tax equality that is rightfully ours to begin with, then I feel that the original battle for equality is lost and we must be resigned to the fact that commercial banks will never again be in the competitive field for the American public's savings dollar.

In short, I am not in favor of any plan whereby our bank would be required to withhold any taxes on the dividend or interest due one of our depositors.

Very truly yours,

J. GRADY COLEMAN, *Cashier.*

SECURITY STATE BANK,
Plentywood, Mont., May 25, 1961.

Mr. L. SHIRLEY TARK,
Main State Bank, Chicago, Ill.

DEAR MR. TARK: I am equally surprised and disappointed to read your letter of May 20th in which you stated that you were going to testify as a witness before the Committee on Ways and Means in support of withholding the tax on dividends and interest.

It is my personal opinion that a great deal more could be accomplished by yourself as a member of the executive committee of the bankers committee for tax equality by continuing to elevate or reduce the competitive advantages of savings and loan associations over banks, rather than making additional concessions for banks.

Yours very truly,

DUANE M. TUCKER, *President.*

THE FARMERS STATE BANK,
Waupaca, Wis., May 26, 1962.

Mr. L. SHIRLEY TARK,
President, Main State Bank,
Chicago, Ill.

DEAR MR. TARK: I sincerely hope that the triumvirate of Tark, Stoddard, and Roth were not successful today in convincing the Ways and Means Committee that you were speaking for all of the bankers in the country in supporting the withholding.

Really now are you three smart bankers gullible enough to think if the bankers are mealymouthed about withholding that it is going to make one iota of difference on the tax equality issue?

Did you ever see a Government plan which was simple? Oh, hell, why get my blood pressure up—just take us off your mailing list.

When, as and if we get withholding which we probably will thanks to do-gooders and are saddled with the extra work to say nothing of making savings less attractive to the average person you will long be remembered I am sure.

Very truly yours,

HARRY W. RAWSON, *President.*

JUNE 5, 1961.

Mr. ARTHUR T. ROTH,
Franklin National Bank,
Mineola, Long Island, N.Y.

DEAR MR. ROTH: I regret very much to read in the June 5 issue of the "American Banker" of the resignations of Mr. Gormley from the executive committee and the executive council of the Bankers Committee for Tax Equality. I am also considerably alarmed over the reasons given by Mr. Gormley for his actions.

I think Mr. Gormley's position is well taken with reference to the saving and loan associations absorbing the tax. Further, the withholding of dividends and interest will drive an enormous amount of funds out of savings accounts into tax-exempt securities.

Even in a small institution such as ours, we have observed the same trend taking place. It seems that the Government is ill advised in attempting this withholding as the public will not stand "hitched" as long as there is an out to relieve themselves of the tax liability.

It is only the small investor that will be caught and hurt because the vast majority of the small investors do not keep an account accurate enough to file a claim for refund. Further, this is a wonderful opportunity for the Government to increase its payroll.

Very truly yours,

E. A. WALTER,
President, Glenwood State Bank.

TEXAS BANK & TRUST CO., OF DALLAS,
Dallas, Tex., May 30, 1961.

MR. L. SHIRLEY TARK,
Cochairman, Bankers Committee for Tax Equality,
Main State Bank, Chicago, Ill.

DEAR MR. TARK: I have a copy of your letter of May 12 to Mr. Stanley Surrey, Assistant Secretary, Department of the Treasury, Washington, D.C., and also a copy of the circular letter sent out on May 20 by you to bankers. I am surprised to learn that your Committee for Tax Equality is advocating the passage of a law requiring the withholding of tax on dividends and interest as proposed by President Kennedy.

This, in my opinion, would be the worst law we could possibly pass, and I don't understand why any banker would be for it. The expense would be terrible, and the detail and redtape would be interminable. I have already written our Senators and Congressmen that I am very much opposed to the passage of this law for many reasons.

Sincerely yours,

P. B. (JACK) GARRETT,
Vice Chairman of the Board.

THE CATONSVILLE NATIONAL BANK,
Catonsville, Md., May 24, 1961.

MR. L. SHIRLEY TARK,
President,
Main State Bank, Chicago, Ill.

DEAR MR. TARK: I have gone over the literature sent out by the Bankers Committee for Tax Equality which gives certain information on the withholding of dividends and interest.

I cannot agree with you that this piece of legislation should be passed for the simple reason that it will create quite a burden on the many banks of this

country who are already performing many free services for the Federal Government. In addition, it will work a hardship on many widows, widowers, and people who are unfamiliar with the law and thereby will not file for a return of money that has been withheld by the banks even though their income would not be sufficient to pay taxes.

In addition to the above, I am sure that the financial institutions will be annoyed continuously by depositors seeking information as to how much money had been withheld and paid to the Federal Government.

I feel quite sure that the Government is talking about "peanuts" when they claim that an enormous amount of taxes on interest and dividend income is not being received. Basically, people are honest and I do not believe there are too many instances wherein people take the chance and not report their income and pay taxes on same.

I am hoping that the various bankers' associations will fight this piece of legislation and see that it is defeated for the many banks of this country.

Very truly yours,

IRWIN P. TRAIL, *President.*

SECURITY STATE BANK,
Albert Lea, Minn., April 24, 1961.

Mr. L. SHIRLEY TARK,
Cochairman, Bankers Committee for Tax Equality,
1000 Connecticut Avenue, Washington, D.C.

DEAR MR. TARK: I have your communication in regard to the President's proposed tax program.

I think the 20-percent withholding on dividends and interest would involve a tremendous amount of work especially for large corporations that are paying dividends and interest on a quarterly basis.

Even a small institution like ours which issue automatic certificates of deposit with interest payable twice a year and interest on savings on a quarterly basis, it would be cause for an awful lot of extra work. I do not favor the law.

If taxes are imposed upon cooperatives, I definitely feel such taxes should apply to savings and loans and mutual savings banks.

Very truly yours,

A. S. LUND, *President.*

CAPITAL FINANCE CORP.,
Columbus, Ohio, June 6, 1961.

Mr. L. SHIRLEY TARK,
Main State Bank, Chicago, Ill.

DEAR MR. TARK: Vernon Scott sent me a copy of the testimony that you, Mr. Stoddard and Mr. Sadlik presented before the House Ways and Means Committee.

This note is just to state that we—and I think practically all the people that I know in our industry who are interested in tax equality—are with you gentlemen 100 percent.

Sorry to note in recent issues of the American Banker that Mr. Gormley and some other members of ABA have registered opposition to the Treasury's proposal for withholding.

With best wishes, I am,

Sincerely yours,

L. J. INGRAM, *President.*

Senator BENNETT. This is a vote, Mr. Chairman.

The CHAIRMAN. The committee will recess while we go and vote.

(Recess was taken.)

Senator BENNETT (presiding). Gentlemen, having voted and until the chairman comes to throw me out, I shall be happy to make it possible for us to continue this testimony.

The next witness is Mr. Gaylord Freeman, Mr. Freeman, I see that you have some large charts on the easel to illustrate your statement.

STATEMENT OF GAYLORD A. FREEMAN, JR., VICE CHAIRMAN, THE FIRST NATIONAL BANK OF CHICAGO, ON BEHALF OF THE ASSOCIATION OF RESERVE CITY BANKERS; ACCOMPANIED BY WILLIAM J. KORSVIK, VICE PRESIDENT, A. ROBERT ABBOUD, ASSISTANT VICE PRESIDENT, AND HENRY GRON, THE FIRST NATIONAL BANK OF CHICAGO

Mr. FREEMAN. Senator Bennett, I am Gaylord Freeman, vice chairman of the First National Bank of Chicago, and I appear here today on behalf of the Association of Reserve City Bankers. I have with me today William Korsvik and Robert Abboud of our bank, who will help me with the charts, and Henry Gron, who prepared the charts.

Although my testimony is some 40 pages in length, I have 10 minutes, so I shall just cover the first 10 pages and the conclusion. I should like to make two points.

Senator BENNETT. Your complete statement will be made a part of the record following your testimony.

Mr. FREEMAN. First, the present bill represents a great advance, two, to achieve equity and raise the revenue needed, it should go even further.

Some of the witnesses have used the figure, $125 billion as the assets of the mutual institutions, and that, indeed, was the figure at the end of 1961. I shall use the figures as of the end of 1960, because we have complete figures for that time.

As of that time, this industry, with assets of over $100 billion, with net income after the payment of all interest and dividends of over $700 million, paid Federal income taxes of less than $5 million. This multibillion-dollar industry paid taxes of less than five one-thousandths of 1 percent of assets, less than one-eighth of 1 percent of net profits before dividends, and less than 1 percent of net profits after dividends. It is obvious that despite the efforts of the Congress in 1951, this industry has remained, in the words of the Secretary of the Treasury, virtually tax exempt.

As a graphic example of this exemption, I would call your attention to the fact that the 402 savings and loan associations in 45 major metropolitan areas listed in my statement with total savings in excess of $7,400 million, and profits after all interest and dividends of more than $65 million, did not pay $1 in Federal income taxes.

Coming closer to home, I would point out that the 24 savings and loan associations in Washington, D.C., and the additional 20 in the metropolitan area, 44 savings and loan associations in all with total savings in excess of $1 billion, and with profits after all interest and dividends of $9 million, paid a total Federal income tax of $500. Yet, despite this obvious inequity, it has taken a great deal of courage on the part of President Kennedy to urge legislation which would enlarge the revenues and contribute to a fair and sound tax structure, and it has taken courage on the part of the Secretary of the Treasury to recommend nondiscriminatory treatment.

It has taken courage on the part of the House Ways and Means Committee—and the entire House of Representatives—to pass the bill in its present form. It reflects courage and considerable wisdom, but

to achieve the revenue that is needed and to accomplish tax equality, it should go much further.

I must confess that in reading section 8, I have some difficulty with the text and with the numerous cross-references, but I would understand that this provides that a mutual—a savings and loan association or a mutual savings bank—can deduct from taxable income, first a reasonable addition to reserves in respect of nonqualifying loans, which is quite appropriate, plus, on qualifying loans, the greater of 3 percent of its loans outstanding, or 60 percent of taxable income, which means that it will pay taxes on only 40 percent of the income, or, as a last resort, it can always have a reasonable reserve.

Senator BENNETT. May I interrupt at this point, Mr. Freeman?

Mr. FREEMAN. Yes, sir.

Senator BENNETT. Will you define nonqualifying loans?

Mr. FREEMAN. The qualifying loans are all real estate loans on which they are allowed a 3 percent reserve. This would include a loan on a small family home or theoretically a loan of $100 million to General Motors secured by a mortgage on their plant.

Senator BENNETT. Before you leave that, one other question. On the nonqualifying loans, are they the so-called 20 percent that have been referred to earlier in today's testimony?

Mr. FREEMAN. Yes, they would include those—some unsecured and passbook loans. Actually, there are very few of them in the savings and loan associations. The great majority of them are qualifying, so that this provision, though quite appropriate, will be relatively unimportant in the total picture.

This bill would provide a much better arrangement than at present, but it has two shortcomings.

In the first place, it produces less revenue than the Secretary's original proposal. I believe that the staff of the joint committee said that it would produce about $160 million. The Secretary's estimate was $200 million, as against what the Treasury asked of $400 million. So it produces less than half the revenue that has been requested.

Secondly, it continues to provide a preference to the mutuals over all other taxpaying business.

Other inadequacies which may not be apparent in a casual reading of the bill include the fact that is provides a 3-percent reserve without showing of any historical loss ratio that would justify a 3-percent reserve. The 3-percent reserve is applicable against all of the qualifying loans. This would include loans that are guaranteed by the Government—FHA and VA loans—although no other taxpayer is allowed reserves against such guaranteed loans.

Thirdly, the permission to deduct 60 percent of the income; that is——

Senator BENNETT. Is Congressman Gavin McIntire here?

(No response.)

Mr. FREEMAN (continuing). Subjecting only 40 percent of the net income to taxation is an obvious preference, and the alternative bad debt deduction which provide that in any event they can have a reasonable reserve, is an indication that even the Congress recognized that these others were beyond reasonable, and hence unreasonable.

Perhaps the best way to see the effect of this provision is to apply it to the average savings and loan association. We can get the

average by taking the total figures for all the associations and then dividing by the number of such associations. We see that the average savings and loan would have footings of about $16 million.

The average saving and loan association would have gross operating income of $855,000 and net income, after the payment of all interest and dividends, of $135,000. Under the present law, it would pay a Federal income tax of $1,000 on that $135,000.

Under the proposed provisions of section 8, this would be increased——

Senator BENNETT. May I stop you at this point?

Mr. FREEMAN. Yes, sir.

Senator BENNETT. Do you have copies of these charts in your prepared text?

Mr. FREEMAN. The text is there, but it is not necessary to insert the charts in the printed record.

Senator BENNETT. The tables are what I mean, because I am wondering whether the reporter is going to get them down.

Mr. FREEMAN. All the tabular material is in the testimony. The textual material here is, of course, a condensation of it.

I was pointing out that under the present law, the average savings and loan association with income of $135,000 now pays a tax of $1,000. On this tax proposal before the committee, this $135,000 of income after dividends would pay a tax of $23,000.

Now, this $23,000 is a substantial increase over the $1,000, but it is still a very small amount. This $23,000 would be less than half of what the average commercial bank would pay on the same income, and it compares with a tax of $61,000 which would be paid by a business corporation. All corporations would pay a tax at a rate of 45 percent, as compared with a 17-percent rate for savings and loans under this new bill.

I do not have to belabor the obvious point that this bill does not achieve equality. It perpetuates the preferential treatment for these mutual savings institutions, and it produces less than half of the revenue which the Treasury sought. Equity demands equal treatment, but if this is politically impossible, then I would urge that the Senate adopt the recommendation of the Secretary of the Treasury and reduce this 60-percent deduction to 33⅓ percent.

Now, the savings and loan associations and the mutual savings banks have from time to time advanced their various reasons to justify this preferential treatment. I have tried to answer them up one by one in my written testimony. I shall be glad to answer them if you have questions later, but I think in view of the hour, we shall skip that.

I shall turn in my statement to the conclusion, and point out that the Treasury, after analyzing all of the arguments of the savings and loan associations, concluded in its report of last July 11 that however valid or invalid those arguments might have been at one time, they—

no longer are sufficiently persuasive to justify a special tax treatment amounting to virtual tax exemption.

Both the need for revenue and the demand for equity require that this committee strengthen the provision of the bill on the taxation of the mutuals. This would take a good deal of courage, because the opposition is sharp, but it is a political rather than a partisan issue.

You will recall that President Eisenhower, in his last budget message, urged that this tax inequality between the competing financial institutions be examined and corrected. You may recall that Dan Throop Smith, who was the Deputy to the Secretary of the Treasury in the last administration, has recently written in his book:

> Savings and loan associations and mutual savings banks are * * * giving an unreasonable tax advantage over competitive taxpaying banks.* * * The differential treatment is neither fair nor conducive to reasonable competition.

On the other hand, you well know the position of the Kennedy administration as expressed by the President and the Secretary of the Treasury.

The nonpartisan but widely based Commission on Money and Credit has similarly urged legislation to insure competitive equality to the extent that the Federal tax is a competitive factor.

Groups as widely divided on other issues as organized labor and organized banks are in accord on this issue. You will recall that Stanley Rutenberg, the director of research for the AFL-CIO, when he appeared before your committee on April 4, said:

> We urge the committee to carefully reconsider the sufficiency of this House proposal.

And so do we.

I believe that it is accurate to say that every impartial group that has considered this issue has recommended that taxes be equalized. If, again, complete equality cannot be achieved, if you cannot subject the mutuals to the limitation that their additions to reserves be reasonable, as is the case with all other taxpayers, then I would urge you to follow the suggestions of the Secretary of the Treasury and reduce their deductible income from the 60-percent to the 33⅓-percent figure.

Modern society requires extensive government services, and these must be paid for by the citizenry. It is largely on the basis of the faith that the average citizen has in the equity and the impartial enforcement of the tax laws that he is willing to pay his taxes without any coercion.

In these 2 days, today and tomorrow, you will hear much testimony on this issue of tax equality as between these two competing institutions. But when the testimony is all over and the witnesses have left, there will remain in your memory, I hope, the hard fact that this industry of over $100 billion, with net income after all interest and dividends of over $700 million, pays income taxes of less than $5 million. And I know that it will raise the question in your mind as to whether you can permit them to continue to escape their fair share of the taxload when you must call on the average workman in this country to pay about one-sixth of his income in taxes. The current heavy military expenditures increase the burden on all of us. But you tell us that this is necessary to preserve the individuals and institutions in our society. If this is true, then every individual and every institution ought to contribute to its own protection. It is on the basis of an equitable apportionment of the tax burden, that I know this committee, after due deliberation, will decide this issue.

Thank you for letting me testify.

Senator BENNETT. Thank you.

Senator DOUGLAS. I want to apologize, Mr. Freeman, for having to leave while you were testifying, but I had three or four things going at one time and I am not able to synchronize them all precisely. I would like to have you try to clear up one issue that has been in my mind.

The testimony this morning and the early part of the afternoon seemed to indicate that of the $160 billion in real mortgages in the country, some $95 billion, or around 60 percent, were held by the building and loan association mutual savings banks, and that the commercial banks held only about $20 billion, which should be 12.5 percent, and that in terms of total assets, the building and loan associations and the mutual savings banks have approximately 80 percent of their total assets in mortgages, residential mortgages, and the commercial banks only 10 percent.

Now, the question I want to ask is this: If homebuilding is extremely important for the American people because it is the physical basis for the American family, to what degree do you think the reduction of the tax advantage which these institutions have had in the past will discourage homebuilding?

Mr. FREEMAN. That is a somewhat complicated question.

Senator DOUGLAS. Yes.

Mr. FREEMAN. I do not believe that it would reduce the amount or increase the cost of funds available for home mortgages at all.

Senator DOUGLAS. Well, if they pay more taxes to the Government——

Mr. FREEMAN. What you are concerned with is, whether if these institutions were taxed, would they attract less in the way of deposits and have less money with which to make mortgages?

Senator DOUGLAS. That is correct.

Mr. FREEMAN. The reason that they attract as much as they do is because they pay more and they pay more because they earn more.

You can see the savings and loan associations average about 5.5 percent as against a varying rate of about 3- to 4-percent earnings on deposits of commercial banks; they earn more because they invest their funds much more fully. They have an aggregate of about 8 percent in cash and governments as contrasted to over 40 percent for the banks; they have over 80 percent in mortgage loans as against 46 percent for the banks.

Senator DOUGLAS. Those loans are real estate loans and not short-term loans, as is primarily the case with commercial banks.

Mr. FREEMAN. Yes, sir. Because of the fact that a great part of our deposits are demand deposits, which we have to be able to pay back quickly, we cannot invest as much of our total assets in long-term loans. But if we would look at the difference in earnings of the commercial banks and savings and loan associations, you will see the big difference is in the earnings rates. They earn more, about a quarter percent more, on their share accounts. We have to pay dividends to stockholders which come to about a third of a percent of our deposits, and our payment of Federal income taxes is a little over half of 1 percent when related to total deposits.

So that the aggregate of those advantages that the savings and loans have over us is about 2.2 percent of deposits or share accounts. If they were taxed just as the banks are, it would reduce the advan-

tage that they have now of 2.2 percent to about 1.6 or 1.7 percent. They would still earn more than we, they would still be able to pay more than we, and consequently, they would still be able to attract large amounts of savings. Hence, taxation would not impair their ability to attract savings.

Mr. Stanley Surrey, Assistant Secretary of the Treasury, in a letter to Congressman Keogh last February, discussing a tax proposal more burdensome than the one before the committee, wrote—

> the possible effects on dividend and interest rates do not appear to be large enough to affect appreciably the growth in savings and share accounts. Moreover, given the anticipated increase over the next 2 years in average rate of return on mortgages, it is very likely that any effect on interest or dividend rates will appear as a smaller increase in yields to depositors rather than as an absolute decline in yields.

Now, if they were taxed, how would it influence the amount of funds available? It would have no influence if it did not divert funds from the mutuals to the commercial banks. It would have an influence if it did divert funds from the mutuals to the commercial banks, and if the commercial banks thereupon invested less of those funds in mortgages than the mutuals would have done.

Now, as to the diversion—the fact is that in February, despite increased competition, the mutuals enjoy a larger increase this year than they did in February a year ago.

At the same time, the commercial banks, and I am just sorry that Senator Hartke is not here, are much more interested in mortgage loans now than at any time since I have been in the banking business. Senator Hartke asked for names of banks that were more active in seeking mortgages. The American Banker recently had an article which said that one of the first banks to start a trend, the First National City Bank of New York, is expanding its mortgage loan program into a major consumer service. The bank will actively solicit loans on single-family homes tailored to meet individual requirements of applicants through its branches.

The same is certainly true of our bank. We are negotiating now with the FNMA to buy all of the mortgages in Illinois. Senator Hartke asked, Why do we buy them in the secondary market? It is because we cannot get new mortgages fast enough. People do not borrow money on mortgages just because there are funds seeking investment, i.e. an investment demand for mortgages. It goes the other way. When they want to buy or build a home, then they create the debt, but we have to wait for them.

We have the vice president in charge of our real estate loan department out in San Francisco and Phoenix this week trying to buy additional real estate loans. The large New York banks which have heretofore not made much in the way of real estate loans are hiring people and setting up their own organizations to make new loans in the New York area. We would much prefer to have new loans than buy old ones. If we buy those from FNMA, we shall get them from Rockford, Decatur, Moline, and Springfield. There are not any more Chicago loans in their portfolio, which we would much prefer, because then we would have them for customers.

If by any chance you looked at the Wall Street Journal of a week ago today, April 4, the feature column had a story on the plethora of mortgage funds, and it concluded:

Builders overwhelmingly report that there is more than enough mortgage money available to finance new homes.

And indeed, the research director for the National Association of Mutual Savings Banks forecast last year:

Some shift of savings will occur in favor of commercial banks, but thrift institutions will place a larger share of assets in mortgages and commercial banks will invest more in mortgages than they otherwise would. The general increased interest in mortgages on the part of most types of lenders will result in a larger flow of mortgage funds in 1962 than in 1961.

This has certainly proved to be true. Not only will there be more funds, but the rates are declining.

I wish Senator Hartke were here so that I could tell him that because of the additional savings that the commercial banks are getting at the new high rates, we must find higher earning opportunities. Municipal bonds offer us one opportunity; real estate loans offer us another opportunity. We would much rather have it in the real estate loans because such borrowers make good customers. We want this kind of a business and we are now, with the opportunity to pay higher interest rates, entering this business enthusiastically. There will be plenty of money and it will be at reasonable rates.

Senator DOUGLAS. Thank you very much.

Senator BENNETT. Thank you very much, Mr. Freeman.

(The complete statement of Mr. Freeman follows:)

STATEMENT OF GAYLORD A. FREEMAN, JR., VICE CHAIRMAN, FIRST NATIONAL BANK OF CHICAGO, REPRESENTING THE ASSOCIATION OF RESERVE CITY BANKERS IN RE SECTION VIII OF H.R. 10650

I am Gaylord A. Freeman, Jr., vice chairman of the First National Bank of Chicago, and appear on behalf of the Association of Reserve City Bankers. Assisting me with my illustrations are William J. Korsvik, vice president, and A. Robert Abboud, assistant vice president, of the First National Bank of Chicago.

I would like to make two major points:

First, the present bill, in its provisions for more effective taxation of the mutual savings institutions, is a great forward step.

Second, both as a source of revenue and to achieve equity, it should go further.

I. THE PRESENT BILL REPRESENTS A GREAT ADVANCE

As you have heard from other witnesses, this is a $125 billion industry today. However, since detailed figures are not yet available for last year, I am going to use 1960 figures in most of my remarks. In 1960 insured mutual savings banks and member savings and loan associations, representing 93 percent of the industry, with:

Aggregate assets of over $104 billion;
Net operating earnings of over $4 billion;
Paid Federal income taxes of less than $5 million.

This multibillion dollar industry paid taxes of:

Less than five-one-thousandths of 1 percent of assets;
Less than one-eighth of 1 percent of net profits before dividends;
Less than 1 percent of net profits after dividends.

It is apparent that despite the congressional efforts of 1951, these financial institutions have remained virtually tax exempt.

As a graphic example of the virtual tax exemption enjoyed by these institutions in 1960, let me point out that the 402 savings and loan institutions in the following 45 major metropolitan areas:

Albany, N.Y.
Schenectady, N.Y.
Troy, N.Y.
Atlantic City, N.J.
Augusta, Ga.-S.C.
Baton Rouge, La.
Brockton, Mass.
Columbia, S.C.
Davenport, Iowa
Rock Island, Ill.
Moline, Ill.
Des Moines, Iowa
Duluth, Minn.
Superior, Wis.
Fort Lauderdale, Fla.
Hollywood, Fla.
Fort Smith, Ark.
Greensboro, N.C.
High Point, N.C.
Greenville, S.C.
Hamilton, Ohio
Middletown, Ohio
Harrisburg, Pa.
Honolulu, Hawaii
Jacksonville, Fla.
Jersey City, N.J.
Johnstown, Pa.
Lawrence, Mass.
Haverhill, N.H.
Little Rock, Ark.
North Little Rock, Ark.
Louisville, Ky.-Ind.
Madison, Wis.
Memphis, Tenn.
Miami, Fla.
Nashville, Tenn.
Newark, N.J.
New Orleans, La.
Providence, R.I.
Pawtucket, Mass.
Racine, Wis.
Reading, Pa.
Richmond, Va.
South Bend, Ind.
Spokane, Wash.
Springfield, Mo.
Springfield, Mass.
Chicopee, Mass.
Holyoke, Mass.
Tacoma, Wash.
Terre Haute, Ind.
Toledo, Ohio
Topeka, Kans.
Waterloo, Iowa
West Palm Beach, Fla.
Wichita Falls, Tex.
Wilkes-Barre, Pa.
Hazleton, Pa.
Wilmington, Del.-N.J.

with total savings of $7.5 billion and aggregate net income after all dividends of $65 million, did not pay one dollar of Federal income taxes.

In addition, the 44 savings and loans in the Washington, D.C. area, with savings of $1.3 billion and net income after dividends of $0.4 million, paid total Federal income taxes of less than $500.

Yet despite the obvious inequity of this discrimination against all other taxpayers, it has taken great courage on the part of President Kennedy to urge remedial legislation which would "enlarge the revenues and contribute to a fair and sound tax structure." It has taken courage on the part of the Secretary of the Treasury to ask for "nondiscriminatory treatment."

It has taken courage on the part of both the House Ways and Means Committee and the entire House of Representatives to attempt to tax these institutions, for they exercise great political power. In addition, it has taken considerable acumen to look beyond the fact that these institutions have channeled considerable sums of private savings into the home mortgage market, and to recognize that equitable taxation would in no way impair the continued flow of an adequate supply of funds to that sector. This bill reflects much courage and much careful thought.

II. BUT THIS PROVISION OF THE BILL MUST BE EXTENDED EVEN FURTHER IF ADEQUATE FUNDS ARE TO BE OBTAINED OR EQUALITY APPROXIMATED

A. The present provisions

Although I must confess some difficulty with the numerous cross-references in the text, the effect of section VIII is to allow a mutual to deduct from taxable income as an addition to its reserve for bad debts the sum of:

1. A "reasonable addition" in respect of all formal securities, passbook, and other (nonqualifying) loans, plus
2. On (qualifying) real estate loans, the greater of—
   (*a*) The amount necessary to bring the reserve for qualifying loans up to 3 percent of such loans outstanding; or
   (*b*) 60 percent of taxable income (reduced by the reserve set aside for nonqualifying loans); or
   (*c*) A reasonable addition to reserves.

Qualifying loans include virtually all loans against improved real property, whether a small home mortgage or, theoretically, a loan of $50 million to the United States Steel Corp., secured by a lien on one of its plants.

The foregoing provision would provide more effective taxation than at present, but it is subject to two faults:

1. It would not produce very much revenue; the Secretary of the Treasury estimated $200 million as against an estimate of $416 million under his original proposal; and
2. This provision would fall far short of placing these moneyed corporations on the same basis as other taxpaying businesses.

Elements of inadequacy which may escape a mere casual reading include the following:

1. The allowance of a reserve of 3 percent, without any showing of need, is unjustified.
2. The 3-percent allowance applies to FHA and the guaranteed portion of VA and any other Government-guaranteed real estate loans—none of which is allowed a reserve in the case of other taxpayers.
3. The limitation of the maximum possible taxable income to a mere 40 percent of net income is wholly unjustified.
4. The availability of two alternative procedures for computing bad-debt deductions, in addition to the one based on "reasonableness," constitutes a recognition that these other alternatives would provide the taxpayer with a deduction which is in excess of reasonable.

Perhaps the best way to evaluate the effects of this provision is to apply it to the average savings and loan association, the balance sheet and profit and loss statement of which can be deduced by dividing the aggregate figures for all insured member savings and loan associations as reported by the Federal Home Loan Board for 1960 by the number of such associations, 4,098. With such figures rounded out for simplicity, the balance sheet of the average savings and loan association would be about as follows:

Average insured member savings and loan association—Balance sheet as of December 31, 1960

[In thousands]

ASSETS	
Cash	$609
Governments and other investments	1,205
Loans	[1] 14,040
Other assets	560
Total assets	16,414
LIABILITIES AND CAPITAL	
Savings capital	14,284
Reserves and surplus	1,131
Permanent stock	24
Other liabilities	975
Total liabilities	16,414

[1] 98.5 percent are first mortgage loans which we are assuming to be qualifying loans.

The 1960 income statement for the average insured member savings and loan (again dividing the combined statement by the number of associations) was as follows:

[In thousands]

Gross operating income	$855
Less operating expenses and other charges (net)	203
Net operating income before dividends	652
Less dividends	517
Net income before taxes but after dividends	135
Less: Federal income tax	1
Net income after taxes	134
Allocation of net income:	
Reserves	124
Surplus	10

The net income after all dividends to shareholders was $135,000 and the Federal tax on this income was only $1,000.

B. Is this adequate taxation?

The proposed provision would subject that income of $135,000 to a total tax of $23,000, or an effective rate of 17 percent.

Gross operating income	$855
Less: Operating expenses and other charges (net)	203
Net operating income before dividends	652
Less: Dividends	517
Net income before taxes but after dividends	135
Deduct 60 percent allocation to reserves	81
Remaining 40 percent of income subject to tax	54
Federal income tax (30 percent first $25,000, and 52 percent remainder)	23
Undivided profits	31
Percent Federal income tax to net income before tax but after dividends	17

This tax of $23,000 is less than one-half the amount which would have been paid by the average commercial bank and contrasts with an effective tax rate of 45 percent (or $61,000) paid by all industrial groups on income before bad debts as reported in Corporation Income Tax Returns, 1959–60.

I do not have to belabor the obvious point. As you will readily see, this is not really equitable taxation. It is a perpetuation of the earlier preferential treatment.

This provision does not adequately "enlarge the revenues" nor contribute to a fair and sound tax structure as the President asked, nor does it provide the "nondiscriminatory treatment" which the Secretary of the Treasury sought. It falls far short of the "equality" of taxation which thousands of your taxpaying constituents would demand if they understood the extent of this continued discrimination.

The $200 million of additional taxes which the present proposal would produce is less than one-half of the $416 million in 1963 (and increasing amounts in succeeding years) which the Treasury recommended in its statement of August 19, 1961. This means that the difference of $216 million which the mutuals would continue to escape (under the present proposal), becomes an additional burden placed on the already heavy tax bill which must be borne by all other taxpayers.

Equity demands equal tax treatment, but if this is politically impossible, then as a minimum, your committee should adopt the recommendations submitted by Secretary Dillon on April 2, 1962, which he estimated would increase the tax to $365 million.

C. Is there any justification for this continued preference?

A number of reasons have been advanced to justify the original exemption and the present preference. Although some of the arguments are patently invalid, in the aggregate they have been sufficiently persuasive in the past so as to require our careful attention to each of them. It is not our purpose, however, to evaluate them as of some prior date but to appraise them in the light of current conditions. Such an evaluation, I submit, will disclose that they are not valid today and that there is no justification for this continued preference.

1. *Should the mutuals be exempt on the grounds that their assets represent the "savings of the poor?"*—If this were true, the average account in the mutual institution would be smaller than that in the taxpaying commercial bank. This, however, is not the case.

Average size of savings account [1]

Taxpaying: Commercial banks	$1,058
Tax avoiding:	
Mutual savings banks	1,614
Savings and loan associations	2,129

[1] Department of Economics and Research, American Bankers Association, Statistics on the Savings Market (1961 edition), table 5.

In the absence of some other evidence, we must conclude that actually, the savers in the mutuals are not the "poor." They are a cross section of the American public, who have larger savings than do the savers in the commercial banks.

2. *Should the mutuals be exempt on the grounds that they are not operated for a "business purpose"?*—The objective of the savers and the managers of the mutual institutions today is to obtain the highest possible return on their capital. As the earning of the highest possible return on capital is the very essence of business purpose, the mutuals should not be exempt on the grounds that they are not operated for a business purpose.

3. *Should the mutuals be exempt on the ground that they do not deal with the general public?*—The mutuals not only do business (that is, accept savings from, and make loans to) such of the general public as walk in, they aggressively solicit the general public to come in and do business.

In 1960, the mutual savings banks spent an estimated $18,125,000[1] in advertising, and the member savings and loan associations $91,097,000.[1]

If we relate total advertising expenditures to earnings we see how very aggressive the mutuals actually are.

Advertising expenditures as a percentage of net operating earnings

Institution:	*Advertising expenditures[1] to earnings (percent)*
Insured mutual savings banks	11.1
Member savings and loan associations	14.4
Insured commercial banks	4.5

[1] In order to put earnings on the most comparable basis, each figure is net operating earnings before income taxes but after deducting dividends on share accounts and interest on savings deposits.

As an indication of the extent of the mutual solicitation of the general public, I call your attention to a recent issue of the New York Times which is typical and which contains advertisements for 26 savings and loan associations located outside New York State.

Whatever the situation was in times past, today the mutuals certainly do business with the general public.

4. *Should the mutuals be exempt on the ground that they need the tax exemption in order to grow?*—Are the mutuals essentially small institutions that need governmental encouragement in order to enable them to grow?

(*a*) Is this a small industry? Assets of the mutual savings institutions today total $125 billion.

(*b*) Are the individual units small? The average savings and loan association at the end of 1960 had assets of $11,391,000. The average mutual savings bank $78,784,000.[2]

There are 110 savings and loan associations of over $100 million each. There are 97 mutual savings banks each with over $100 million in asets, four with assets in excess of $1 billion.

These aren't struggling small businesses that need Government support.

(*c*) Are they growing very slowly? Mutual savings banks since 1950 have increased their deposits by $16,302 million, or a growth of 81.5 percent. The savings and loan associations have increased their share accounts by $48,162 million or 343 percent. The savings and loan rate of growth is three times the rate of growth of time deposits in the commercial banks and almost seven times as rapid as the increase in total deposits.[3]

Thus, these mutuals, (i) constitute a tremendous aggregation of wealth, and (ii) are growing extremely rapidly.

(*d*) But would they have been able to grow without tax exemption? This requires a moment's consideration of why the mutuals have grown so rapidly.

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[1] FDIC insured mutual savings banks; savings and loan association, members of FHLB, 1960; commercial banks, FDIC insured banks, estimated, 1960.

Source: Banking (March 1960), p. 68; FDIC, Annual Report, 1960, pp. 176, 177; FHLB Board, Combined Financial Statements, 1960, pp. 16, 72, 73, National Association of Muual Savings Banks.

[2] For comparison, the average size of the commercial banks is $19,118,000, and the average of their total time deposits is $5,450,000.

[3] The increase of total deposits in commercial banks was $74.5 billion, or 48 percent; time deposits increased $35.1 billion, or 96.2 percent.

(i) They advertise aggressively, they generally occupy attractive quarters and offer pleasant service, but the primary reason that they attract savings is because they pay a higher rate of return than do their competitors.

Average rates paid[1]

[Percent]

Year	Taxpaying commercial banks	Tax-avoiding: Mutual savings banks	Tax-avoiding: Savings and loan associations	Year	Taxpaying commercial banks	Tax-avoiding: Mutual savings banks	Tax-avoiding: Savings and loan associations
1950	0.94	1.90	2.5	1956	1.58	2.77	3.0
1951	1.03	1.96	2.6	1957	2.08	2.94	3.3
1952	1.15	2.31	2.7	1958	2.21	3.07	3.3
1953	1.24	2.40	2.8	1959	2.36	3.19	3.5
1954	1.32	2.50	2.9	1960	2.56	3.52	3.7
1955	1.38	2.64	2.9				

[1] Department of Economics and Research, American Bankers Association; Statistics on the Savings Market (1961 ed.) table 7.

(ii) To some extent the mutuals can pay a higher rate because they pay a return to only one group, the saver-owners, whereas the commercial banks have two groups to compensate. This is aggravated by the fact that the entire distribution which the mutuals pay, both to the saver as interest on his savings and to the equity owner (who, in their case, is the same person) as a return on his equity, is tax deductible, whereas what the commercial banks (or any other corporation), pays to its owners is not tax deductible.

(iii) But the principal reason that the mutuals can afford to pay more is because they earn more.

Averaging earning rate[1] *(current operating earnings to deposits or shares)*

Year	Taxpaying insured commercial banks	Tax-avoiding: Insured mutual savings banks	Tax-avoiding: Member savings and loan associations
1951	2.693	3.343	5.088
1952	2.878	3.386	4.992
1953	3.132	3.520	5.073
1954	3.149	3.626	5.102
1955	3.339	3.774	5.253
1956	3.680	3.925	5.326
1957	4.015	4.102	5.495
1958	3.951	4.215	5.543
1959	4.415	4.480	5.801
1960	4.683	4.645	5.970

[1] FDIC annual reports, 1951-60. FHLBB combined financial statements, 1951-60.

(iv) The mutuals can earn more because, inasmuch as they are not required to maintain liquidity comparable to that required of the commercial banks, the mutuals can invest virtually all of their funds in high return assets.

Percentage and distribution of assets, Dec. 31, 1960

[In percentages]

	Commercial banks	Mutual savings banks	Savings and loan associations
Cash	20.25	2.18	3.80
U.S. Government securities	23.61	13.64	6.41
Other securities	8.00	14.60	
Loans	45.85	67.96	84.05
Other assets	2.29	1.53	5.74
Total	100.00	100.00	100.00

Thus, as the mutuals can invest more in high-rate assets, they can earn more. As they can earn more, they can pay more. As they can pay more, they can attract more savings.

(e) Would subjecting the mutuals to Federal income taxation on the same basis as the commercial banks materially affect the rate which they can pay? As we have seen, the mutuals grow more rapidly because they pay a higher rate. They can pay a higher rate for three reasons: (i) they have higher earnings; (ii) they don't pay anything to stockholders as distinguished from savers; (iii) they do not have to pay any Federal income tax. Let us compare the relative importance of these three advantages.

Reasons why savings and loans can pay a higher return than commercial banks [1]

[Computed as a percent of total deposits or share accounts]

	Commercial banks (insured)	Savings and loan associations (insured)	Difference
Gross operating earnings	4.683	5.970	1.287
Dividends to stockholders	.363	....	.363
Payment of Federal income tax	.568	.007	.561
Their net advantage	....	....	2.211

[1] FHLB Board combined financial statements, 1960, pp. 16, 72. FDIC annual report, 1960, pp. 148, 154.

Although the commercial bank in 1960 paid Federal income taxes at about 80 times the rate paid by the savings and loan associations, the amount of the tax differential is only slightly more than one-half of 1 percent of deposits.

Thus, the removal of the tax differential would not eliminate the mutuals' ability to pay a higher rate—and attract more savings. At most, it would reduce their net advantage from 2.211 percent to 1.650 percent.[4] This means that the savings and loan associations would still enjoy a substantial advantage and would continue to grow rapidly.

It is the mutuals' ability to earn more which gives them their great advantage. It is therefore clear that the mutuals do not need tax exemption in order to grow.

In passing, let me make one other point—the tax treatment now accorded the mutuals is not only unnecessary for growth, it has the unique and wholly undesirable result of favoring the larger mutual at the expense of the smaller.

In 1960 the Federal income taxes paid by member savings and loan associations with assets under $500,000 amounted to 9.39 percent of the net taxable income (viz: net income after dividends but before reserves). The savings and loan associations with assets between $2½ and $5 million paid Federal income taxes at the rate of about 1.5 percent, and the savings and loan associations with assets over $100 million paid Federal income taxes at the rate of 0.11 percent of taxable income. (Table I, appendix.)

The larger the associations, the less of their income they pay in taxes. Indeed, the associations with assets in excess of $100 million paid Federal income taxes at only one-eightieth the rate paid by the associations with assests under $500,000.

This is not only directly contrary to our national concept of progressive taxation, it is retrogressive, the preference of the large and wealthy and the penalization of the small.

5. *Does our desire to encourage savings justify granting tax exemptions to the mutuals?*—There is no question as to the importance of thrift. The discipline builds character and the resultant savings assure greater independence. Perhaps more important is the fact that national growth depends largely on capital investment, which in turn requires savings—the willingness to consume less than we produce, and to invest that difference in productive assets.

[4] Even this assumes that the mutuals would increase their after-tax capital funds at the same rate that the commercial banks do. If, however, they elected, as they have in recent years, to spend much more on advertising and to continue to pay a higher return, the amount that they would pay in Federal income taxes would not approach the proportion paid by the commercial banks, and they would suffer virtually no diminution in the amount which they could pay to the saver.

In this connection, it is interesting to note that about 69 percent of our private savings is by business, and 31 percent by individuals.

Of the increase in total savings in 1960, $7.6 billion, or 10 percent, went into savings and loan associations; $4.1 billion, or 5.5 percent, went into the commercial banks; $1.4 billion, or 1.9 percent, went into mutual savings banks.

If, as a national policy, we want to encourage total savings, we should offer some inducement for all forms of savings, perhaps a credit against income, of corporations and individuals alike.

If for some reason the Congress were to prefer to encourage personal savings only, it should offer some inducement to all individual savers, irrespective of the particular form of their savings.

Merely giving preference to one group—and that group not the savers but the institution—is neither equitable nor effective.

Thus the desire to encourage savings does not justify the present tax exemption.

6. *Does the fact that income retained by the mutual is not immediately allocable to an individual depositor (or shareholder) mean that there is no income received, hence there should be no tax?*—Income received and retained by any business corporation is income to the corporation, not to the individual stockholders thereof. The stockholder does benefit from the retained earnings as they are reinvested in the business. However, neither the saver in the commercial bank nor the saver in the mutual receives any increase in his principal as a result of any improvement in earnings.

The stockholder in the commercial bank may, if and when he sells his stock, realize a price which, in part, reflects retained earnings (although it would be difficult to relate widely fluctuating stock prices to book value). But if the mutuals should argue that the saver in the mutual is the equity owner and hence should be compared to the stockholder (as distinguished from the saver) in the commercial bank, we would agree. However, if the mutuals take this position, then they must acknowledge that the proportion of income paid to the mutual saver as the equity owner should no more be tax deductible to the mutual than is the amount paid in dividends to the stockholder of the commercial bank deductible to it.

The mutual's argument that there should be no tax because no individual is yet entitled to the distribution is not valid.

7. *Should the mutuals be exempt on the grounds that they cannot invest in every form of asset?*—Admittedly, there is a variety of types of assets in which the different institutions can invest. There is also a wide difference in the amount which they are free to invest. As we have noted previously, it is the commercial banks which are required to maintain the greatest liquidity (cash and U.S. Government securities) and hence have the least opportunity to obtain adequate earnings. Consequently, if there were to be any preference, the preference should be in favor of the commercial banks.

The fact that there is a variety of limitations on the different types of institutions is no justification for granting tax exemption to the mutuals.

8. *Does the need for safety require tax exemption for the mutuals?*—The mutuals argue that they need large reserves in order to abe able to absorb the losses which they might sustain were we to enter another depresion comparable to that of the thirties.

We would agree wholeheartedly that they should be allowed to build up reasonable reserves, but to be reasonable—

(*a*) The reserves should be related to the amount of assets at risk, not to total liabilities. This is so obvious as to be self-evident. If you don't have anything at risk, you don't need a reserve to protect yourself against the nonexistent risk.

(*b*) The reserves should be related to the degree of risk of loss inherent in those assets.

The question here is how much risk is there in the mutuals' assets? They have not heretofore presented any information on this; indeed, they have claimed that no such data is available.

However, the Treasury Department pointed out in a Report on the Taxation of Mutual Savings Banks and Savings and Loan Associations last July that, "The savings banks (during the great depression) were able to abosrb their mortgage losses out of the current income received during the period in which the losses occurred."

Dr. Raymond Goldsmith, of the National Bureau of Economic Research, has prepared an analysis of the losses of savings and loan associations and commercial banks during the 16 years 1930–45.

On the annual average basis for the full 1930–45 period; losses were 0.95 percent of loans for savings and loan associations and 0.86 percent for commercial banks.[5] Thus the loss experience for the two types of institutions was quite comparable.

But the commercial banks suffered their losses in a short almost catastrophic depression, whereas the savings and loans spread their losses over a much longer period of time. Thus during the 5 worst years of the period 1930–45 commercial bank losses averaged 1.8 percent of the annual loan portfolio, whereas for savings and loan associations the loss for this period was 1 percent, only about half the commercial bank loss rate.

It should also be noted that in no single year—including the worst years of the depression—did the savings and loan associations suffer a loss in excess of 2.2 percent of loans while the commercial banks experienced losses at the rate of 3.3 percent of loans.[6]

A comparison taken from Dr. Goldsmith's study showing losses for the period 1930–45 may be of interest.

Losses on loans: Commercial banks, savings and loan associations, 1930–45 (operating institutions)

Year or period	Commercial banks' net losses on loans		Savings and loan associations net losses, total	
	Amount (millions)	Percent of total loans	Amount (millions)	Percent of mortgage loans
1930	$235	0.7	$2	0.03
1931	357	1.2	43	.7
1932	498	2.2	84	1.5
1933	515	2.8	88	1.8
1934	516	3.3	48	1.2
Total, 1930–34	2,121	8.9	265	4.9
1935	243	1.6	76	2.2
1936	143	.9	52	1.6
1937	53	.3	32	1.0
1938	95	.6	24	.7
1939	72	.4	53	1.4
Total, 1935–39	606	3.7	237	6.9
1940	49	.3	59	1.5
1941	34	.2	43	1.0
1942	12	.1	35	.8
1943	+11	+.1	23	.5
1944	+14	+.1	23	.5
1945	+11	+.05	+6	+.1
Total, 1940–45	59	.3	177	3.9
Total, 1930–45	2,786	13.8	679	15.2

NOTE.—Average annual percent loss: Commercial banks, 0.86 percent; savings and loan associations, 0.95 percent.

From the foregoing, it is obvious that adequate reserves are important to all of these competing institutions. It is even more obvious that there is no justification for a tax law that allows the commercial banks to build reserves of 1 percent of deposits and the mutuals to build reserves 12 times as large. The present virtual tax exemption awarded the mutuals is clearly unfair and unjustified.

(c) We are not pressing for any severe limitation upon the amount which the mutuals can deduct from taxable income. We are only urging that they,

[5] Dr. Raymond Goldsmith, "A Study of Savings in the United States," Princeton University Press, 1955.

[6] See, also, New York State Bankers Association. "A Report of the Committee on Risk Asset Ratio Study," March 1952.

like commercial banks and all other taxpayers, be allowed "reasonable" reserves, and that the determination of what is reasonable should be made by the Commissioner of Internal Revenue, as in the case of all other taxpayers. If the Commissioner is competent to determine what is reasonable for all other taxpayers, he ought to be competent to determine what is reasonable for the mutuals.

Certainly, the need for safety does not justify the present virtual tax exemption.

9. *Do State or Federal "requirements" necessitate the grant of a tax exemption to the mutuals?*—It is argued that:

(*a*) applicable State or Federal laws require the mutuals to maintain certain reserves; and

(*b*) the Commissioner may be unwilling to allow the tax-free deductions of such reserves.

Neither point is valid.

Various laws require that, as in the case of the commercial banks, the mutuals must retain a portion of their income to build up strength and can only distribute the balance to savers and stockholders. There is no requirement, nor, indeed, any need, that these additions be made from pretax income. As a commercial banker, I would be delighted to have the opportunity to build up our strength entirely from tax deductible reserves, just as would any other businessman. But we are not accorded this opportunity, nor has it deterred the banks in building up our margin of safety.

In the past decade (1950 to 1960) the commercial banks have increased their capital accounts almost exclusively from retained earnings in the sum of $9.3 billion, an increase of 80 percent.[7]

Indeed, it is arguable that the present tax exemption is not only unnecessary in the case of the mutuals, but that it has not been effective in encouraging them to increase their safety.

Capital or reserve funds to deposits (share accounts),[1] 1945–60

[Selected years—dollars in thousands]

Year (Dec. 31)	Insured commercial banks	Insured mutual savings banks	FHLB member savings and loan associations
	Percent	*Percent*	*Percent*
1945	5.87	9.98	8.70
1950	7.79	12.16	9.16
1955	8.52	10.34	8.02
1959	9.77	10.01	8.16
1960	10.05	10.21	8.15

[1] Source: ABA, The Commercial Bank Case for Tax Justice, table 1, p. 10 and FDIC Annual Report, 1960, pp. 147, 148, 149; and FHLB Combined Financial Statements, 1960, p. 16.

The savings and loans have not used these tax advantages to build up strength, their reserves have actually declined in relation to their deposits (share accounts).

It is apparent, both from the argument and past practice, that the present tax exemption is not necessary in order to enable the mutuals to meet requirements for additions to reserves, nor has the present law been helpful in increasing the safety factor which they offer the public.

10. *Is tax favoritism necessary to divert savings into home mortgage loans?*—(*a*) Adequate taxation will not produce the dire consequences to the residential mortgage market the mutuals predict.

1. The mutuals have repeatedly tried to create the impression that if their tax status were changed, the adverse impact on the housing industry would be both grave and direct. This is not so. A hidden tax subsidy, directed through a special purpose lender, will not, by itself, assure prosperity to any industry. The complex housing market cannot be stimulated or retarded in such a simple push-button way. Other factors governing the demand for housing which also must be considered, include: the basic cost to the consumer exclusive of financ-

[7] FRB, Bulletin, May 1961, p. 557 and Feb., 1950, p. 165.

ing; profitability to contractors and their capacity to borrow; the availability of desirable locations served by adequate commuter transportation; the proximity of schools, utilities, and other shopping facilities, all of which, incidentally, the commercial banks finance to a far greater extent than do the mutuals. If subsidies are needed to accelerate building, let them be forthrightly bestowed and temporarily granted to that aspect of the industry evidencing the greatest momentary need, instead of permanently hidden in the tax structure to the benefit of a privileged minority.

(*b*) Adequate taxation will not force the mutuals to cut their dividends to savers and, hence, impair their ability to attract additional capital.

i. Reductions in interest rates, if any, will be small. Many mutuals will simply decrease their transfers to reserves, and hence, their ability to pay dividends will not be affected. As Assistant Secretary of the Treasury, Stanley S. Surrey pointed out in his letter of February 7, 1962, to Congressman Keogh, discussing proposals considerably more burdensome than the present proposal;

"The possible effects on dividend and interest rates do not appear to be large enough to affect appreciably the growth in savings and share accounts. Moreover, given the anticipated increase over the next few years in average rate of return on mortgages, it is very likely that any effect on interest or dividend rates will appear as a smaller increase in yields to depositors rather than as an absolute decline in yields."

(*c*) Adequate taxation will have little effect on the availability or costs of residential mortgage money.

The availability of mortgage money will not be automatically affected just because the mutuals are taxed. Taxation of the mutuals will certainly not influence the demand for mortgage money. Will it influence the supply?

It will only if—

i. it diverts a large volume of savings from the mutuals to other depositories, and

ii. the other depositories are disinterested in mortgage loans.

i. To what extent will equitable taxation divert savings from mutuals to other depositories?

We do not anticipate any shift of existing savings, and even the diversion of new funds from the mutuals will be slight. They will still be able to pay a higher rate of return to the saver than the commercial banks because they will continue to earn more. The capacity of the savings and loans to compete is evidenced by the February increase in savings which was realized despite a substantial increase in interest rates paid by commercial banks. The FHLBB reported that during February 1962 insured savings and loans increased savings capital by $559 million compared with $544 million during February 1961.

ii. Despite the slight diversion of savings from the mutuals, the impact on the mortgage market would be more than offset by the increased enthusiasm of other lenders.

At no time in the past have the commercial banks been as active in seeking mortgage loans as at the present moment. The increased competition for savings deposits and the higher rates being offered have made it necessary for many commercial banks, which have not heretofore made mortgage loans, to vigorously seek them. Others which have had moderate portfolios are seeking to increase the volume of such loans.

This development has become so widespread among the commercial banks that Mr. M. L. Dye, president of the U.S. Savings and Loans League in his address to the league on March 1, 1962 complained:

"Competition from the commercial banks in the home mortgage field may be a more serious threat to associations than the new bank savings rates."

This is not a matter of the moment. The commercial banks faced with the payment of higher rates on savings have to invest their additional savings in loans producing higher rates, and mortgage loans are most attractive. If taxation should cause some shift in deposits from mutuals to commercial banks, the banks would invest a high percentage of such funds in mortgage loans.

In this connection the Mortgage Finance Committee of the American Bankers Association has proposed the establishment of two private corporations, publicly supervised, for the insuring of conventional mortgages and for the secondary financing of such mortgages. This constitutes still another attempt to stimulate increased mortgage lending. Accelerating their activities in the residential mortgage area are pension funds, trusts, mortgage companies, investment companies, credit unions, fraternal orders, and others.

Thus there is no present shortage of mortgage money and there is not likely to be in the foreseeable future. The feature article in the April 4, Wall Street Journal concludes:

"Builders overwhelmingly report that there is more than enough mortgage money available to finance new homes."

Dr. Saul B. Klaman, director of research, National Association of Mutual Savings Banks, forecast in the March 1961 Mortgage Banker:

"Some shift of savings will occur in favor of commercial banks, but thrift institutions will place a larger share of assets in mortgages and commercial banks will invest more in mortgages than they otherwise would. The general increased interest in mortgages on the part of most types of lenders will result in a larger flow of mortgage funds in 1962 than in 1961. The demand for mortgage funds will increase only moderately, reflecting the small rise in housing activity and the shifting of housing markets."

Dr. Jules I. Bogan, professor of finance, New York University School of Business Administration, wrote in the December 1961 Mortgage Banker:

"For the next 5 years or so, net family formation will average around 800,000 per annum, which will hold down demand for homes and consumer durable goods. The supply of funds from savings institutions and bank credit expansion promises to be adequate to satisfy prospective demands, and will exceed prospective demands in periods of less active business and recession."

Mortgage money promises not only to be plentiful, but also cheap. James C. Downs, Jr., chairman of the board, Real Estate Research Corp., writing in the March 1962 National Market Letter, stated:

"There is a commonly held belief that costs are controlling prices. The fact is, of course, that markets control prices, for money as well as other goods. The fact that banks and savings and loan institutions are paying more for their money is no more valid reason for higher interest than that rents should go up when a property owner gets a tax increase. The supply of mortgage money, like the supply of rental space, is increasing more rapidly than the demand for mortgages at current rates. Ergo: lower mortgage interest."

Thus we may conclude that equitable taxation will not materially affect either the supply or the cost of mortgage funds.

11. *If the Savings and Loan Associations were taxed on the same basis as other corporate taxpayers, would anyone be hurt?*—(*a*) The savers cannot be hurt.

i. The savers who have put their money in the savings and loan associations are "shareholders," but no matter what capital or reserves the institutions may build up, the shareholder is entitled to get back only the amount that he puts in (plus his interest or dividend return). He gets no share of the equity. The capital or reserves remain in the institution until liquidation.

Thus, the saver has no present equity (like the stockholder in an oil company) to be affected by the imposition of regular corporate income taxes. The only effect he could feel is:

ii. The possibility of some prospective reduction in rates of interest (dividends) paid in the future, but, this will have no effect on the value of his present ownership. Furthermore, since the total tax bill would only be a very small percentage of savings capital, full taxation of the savings and loan associations would still permit them to pay a return substantially higher than that paid by their competitors and probably would not cause them to make any reduction in the rate they pay to the saver.

iii. If the savings and loans paid a tax and did not reduce their dividends at all, the amount of the tax paid would have to come from undivided profits. There is no equity in this as it is the case with all corporate taxpayers.

But, though equitable, would taxation cause the insured savings and loan associations to become unsound?

The savings and loans now have capital and reserves of 7 percent of total assets (compared with 8 percent for all insured commercial banks). Thus, the savings and loans start off from a good base.

The retained earnings added by the savings and loans to their capital and reserves (for the past 5 years) have averaged 0.9 percent of assets each year (compared to 0.4 percent for insured commercial banks).

Thus it is clear that if taxed like commercial banks (with the same deductible reserves for bad debts), the savings and loan associations could maintain their dividend rate, absorb the tax and still add more to capital and reserves than can the commercial banks.

(b) It is doubtful if even the stockholders would be hurt.

Investors who own common stock in savings and loan associations represents a very small group. There are only 520 savings and loans[8] with common stock outstanding out of a total of 6,276 savings and loan associations. Only those few who own these negotiable securities would feel the impact of somewhat reduced net earnings if they paid a tax. And it is by no means certain that this group would suffer any loss whatsoever.

Savings and loan common stocks have recorded a growth of 205 percent over the past 2 years.[9] Except for the relatively few investors who made initial purchases during the past several months, owners of these equities have fared very well indeed. It is conceivable that modest income taxes might slow down the rate of growth somewhat, but certainly the basic trend would not be reversed.

Kidder, Peabody & Co. in its 1961 edition of "The Savings and Loan Industry" writes: "The holding company associations would be in the extremely advantageous position of being able to obtain additional capital contributions—which funds the holding companies could obtain quickly and easily through public sale of senior securities—permitting the associations to accept all available savings. Such additional long term growth potential would be denied the mutual associations. The relative advantage to the public companies would more than make up for any substantial change in the industry's tax status, in our opinion."

A change in the tax law would not influence the investment of any mutual depositor or shareholder. It might have some effect on the stockholders of the few stock owned companies who have heretofore enjoyed an unwarranted windfall but the purpose of tax revision should be justice not the perpetuation of injustice.

IV. CONCLUSION

The proposed increase in the taxation of mutual savings institutions is a long step toward greater revenue and more equitable treatment. The proposal represents both courage and judgment.

Yet it is only a partial step. The Senate should expand the provisions of section VIII for the proposal would not bring in adequate additional revenue nor would it achieve anything approaching tax equality.

The mutuals, seeking to perpetuate their virtual tax exemption suggest a variety of reasons why they should be given preferential treatment, but a review of these arguments demonstrates that they are without validity. As the Treasury stated in its July 11, 1961 Report.

Differences between the mutual thrift institutions and other financial intermediaries which have been advanced in the past to justify special tax treatment for the mutuals * * * no longer are sufficiently persuasive to justify a special tax treatment amounting to virtual tax exemption. From the viewpoint of logical and equitable application of the Federal income tax, the mutual thrift institutions should be able to retain corporate earnings tax free only under a formula consistent with established concepts for computing bad debt reserves."

To press for more equitable treatment will take considerable courage on the part of this committee, but both the need for revenue and the interest of justice demand it. There will be some inspired opposition, but though this may be a political issue it is not a partisan one.

Representatives of both parties and of the public at large are of one mind on the need for ending this preference.

President Eisenhower in his last budget message to the Congress urged a review of "the tax laws which now apply to the Nation's various private lending institutions * * * and to remedy any inequitable situations * * *"

Professor Dan Throop Smith, Deputy to the Secretary of the Treasury in the Eisenhower administration, in his recently published "Federal Tax Reform" states:

"Savings and loan associations and mutual savings banks are * * * given an unreasonable tax advantage over competitive taxpaying banks. * * * The differential treatment is neither fair nor conducive to reasonable competition."[10]

The Kennedy administration has made its position abundantly clear in repeated statements of the President, Treasury Secretary Dillon, and the report of the Treasury. All have urged equitable taxation of the mutual savings banks and the savings and loan associations.

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[8] U.S. Savings & Loan League.

[9] Kidder Peabody Index of Savings and Loan Stock Prices, Mar. 30, 1960 through Mar. 21, 1962.

[10] Dan Throop Smith, "Federal Tax Reform" (McGraw-Hill, 1961).

The nonpartisan and widely representative Commission on Money and Credit has similarly urged ending this preferential tax treatment.

"The commission recommends that commercial banks, mutual savings banks, and savings and loan associations be subjected to the Federal corporate income tax in such fashion as to contribute to capital and reserve adequacy and to insure competitive equality (to the extent that the Federal tax is a competitive factor.)" [11]

The public is equally clear on the need for greater taxation of the mutuals. Groups as widely divided on other issues as organized labor and the banking business agree.

As Stanley H. Ruthenberg, director of research, AFL-CIO stated before your committee on April 4:

"We urge the committee to carefully reconsider the sufficiency of this House proposal."

So do we.

I believe it is accurate to state that no group which has examined this question impartially has supported the present preferential treatment accorded the mutuals. It should be ended.

If complete equality cannot be achieved—if it is not practical to subject the mutuals' tax deductible reserves to the test of "reasonableness" required of all other taxpayers—then at the least the Congress should limit the deductible reserves to the 33⅓ percent of net income as recommended by the Secretary of the Treasury in his testimony on April 2.

Modern society requires extensive governmental services. These must be paid for by the citizenry and an equitable distribution of this burden is absolutely necessary to a free society. It is largely because of faith in the equity, uniformity, and impartial enforcement of taxes in this country that most Americans meet their obligations without any form of coercion. During times of emergency, they willingly agree to accept their tax obligations because they know that their fellow citizens will share these burdens with them.

In these 2 days, you will hear much testimony in regard to taxation of the mutuals. You will weigh that testimony in the light of the personal interest of those who are accorded the privilege of addressing you—just as you will weigh what I have had to say knowing the commercial banks for whom I speak are engaged in competition with these tax-favored institutions.

And yet, after all the arguments have been presented to you, the hard fact will remain in your memory that an industry with $104 billion in assets and with net operating earnings of over $4 billion, paid Federal incomes taxes of less than $5 million. No amount of impassioned explanation or statistical elaboration can make those figures consistent with an equitable distribution of the tax burden.

The current heavy military preparedness program places a heavy financial burden on each of us. We bear it willingly because it is necessary for our very survival.

That expenditure benefits all Americans and its cost should be borne equitably by all Americans.

It is on this basis of equitable allocation of the costs of governmental services and of national defense that I know this committee will, after due deliberation, decide this question.

Appendix

TABLE I.—*Federal income taxes paid by savings and loan associations in various asset classifications*

[Unit: Thousand dollars]

Assets	Net income	Net taxable income	Federal income tax	Federal income taxes as a percent of net taxable income
Under $500,000	2,955	245	23	9.39
$2,500,000 to $5,000,000	150,164	30,854	453	1.47
$100,000,000 and over	559,019	113,534	120	.11

Source: FHLB. Combined Financial Statements, 1960, pp. 74, 75.

[11] "The Report of the Commission on Money and Credit" (Prentice-Hall, 1961), p. 173.

Senator BENNETT. Our last witness is Mr. R. E. Gormley, of the Georgia Savings Bank & Trust Co., Atlanta, Ga.

STATEMENT OF R. E. GORMLEY, VICE PRESIDENT, GEORGIA SAVINGS BANK & TRUST CO., ATLANTA, GA.

Senator BENNETT. Sit down and identify yourself for the record.

Mr. GORMLEY. You are very patient, Mr. Chairman. I am R. E. Gormley from Atlanta, Ga. I am vice president of the Georgia Savings Bank & Trust Co., of that town. It is a stock savings bank.

I requested permission to appear before you in behalf of five other like savings banks operating in Georgia, as well as similar banks operating in other States.

While comparatively few in number, I hope our experience will be of interest to you in arriving at a decision as to a fair method of taxation of so-called mutual lending institutions. I say this for the reason that we do practically the same type of business as Federal savings and loan associations, the only difference being that we pay a full corporate Federal income tax, while they do not.

Now, a great deal has been said pro and con on this question. I have assumed that you gentlemen would not be so much concerned with the competitive effect which the operations of savings and loan associations and mutual savings banks have on commercial banks, but rather whether or not the operations of those groups now enjoying high tax-free loss reserve positions, will be that seriously affected should their present loss reserve position be eliminated or reduced, their functions would be seriously curtailed.

It seems to me the primary questions to be resolved are, first, is the financing of homes a social or semieleemosynary type or operation of such nature as to justify a tax status different from that of other profitmaking types of businesses? Second, is the mortgage loan business that hazardous as to warrant a tax-free loss reserve to savings and loan associations and mutual savings banks which has practically relieved them of paying Federal income taxes?

I trust my own experience in the mortgage loan business will be helpful to you in determining the answer to these questions.

I am conscious of the fact there has been a disposition on the part of some of our legislative forces to regard these operations as semisocial or public benefactor types of operations. While it is true they were originally conceived as a patriotic movement, the claim of mutuality by these present-day lenders, and the fact their loans are almost exclusively for the purpose of enabling people to purchase and maintain homes, does not, in my opinion, justify placing them in a class with the YMCA or the Boy Scouts.

I do not think they can be regarded as purely mutual. First, for the reason they do not distribute all of their net earnings each year to their so-called mutual owners. I hope to show that the percentage of earnings retained each year is far in excess of any true reserve requirements. My contention is that the percentage of earnings re-

tained and transferred to surplus, undivided profits, and reserves, constitutes a capital position created out of nontaxed earnings rather than a necessary loss reserve.

Second, as to the hazard involved in making mortgage loans, I think the testimony of representatives of both mutual savings banks and savings and loan associations, before the Ways and Means Committee of the House and at a hearing held by the Treasury Department, during the summer of last year, failed to bear out the facts there is any extraordinary hazard in the making of such loans.

As an illustration of my contention, I would like to cite my own experience in the mortgage loan business.

The Georgia Savings Bank & Trust Co., with which I am associated, is a capital stock savings bank. We do exactly the same type of lending as do savings and loan associations. We commenced business in 1899. We have the same charter as other State banks operating in Georgia. We do a savings deposit business, exclusively, by election. Our loans are almost entirely, in fact 98 percent, secured by first mortgages on residential property in and around Atlanta. We have found this type of lending to be not only safe, but highly profitable.

In the worst 20 years' experience of our operations, from 1925 to 1945, which carried us through the Big Depression, our loss percentage on loans was only 0.43 percent, or less than one-half of 1 percent. While it is true we have not been able to grow in proportion to other lending types of institutions, our business has been most satisfactory from a profit standpoint.

With an original paid-in capital of $500,000, we have been able to build, out of retained earnings, after paying full Federal income taxes, a surplus, undivided profits and reserves of $2,300,000. Our present deposits are approximately $14 million. Our total resources, approximately $18 million. It would seem, therefore, that since a privately owned institution, doing practically the same type of business, can provide an adequate loss reserve and increase its capital position, after paying full Federal income tax, there is no reason why these so-called mutual lending institutions, with no stockholder interest, cannot provide an adequate loss reserve, after paying Federal income tax as do other corporations.

The experience of my own bank is not the result of any superior management, but rather shows that loans secured by first mortgages on residential property are the safest loans which can be made.

When a savings bank with total resources of less than $18 million, such as my own institution, pays a Federal income tax of over $146,000 on its 1960 income, and the 67 insured savings and loan associations operating in Georgia, with total resources of over $1 billion, pay a total Federal income tax on 1960 earnings of only $31,000—I would like to repeat those figures, if you please. A single bank with less than $18 million pays the full Federal income tax. We paid 52 percent, incidentally. The 67 insured savings and loan associations operating in Georgia, with total resources of over $1 billion, pay a total Federal income tax on 1960 earnings of $31,000. One can't help but wonder what is to become of the private capital system of financ-

ing. In fact, is not our entire boasted system of private enterprise in jeopardy?

I made the statement earlier that neither mutual savings banks nor savings and loan associations have been able to cite any loss experience figures which would justify a loss reserve of even as much as 3 percent.

Mutual savings banks, with total resources now of approximately $40 billion and loans of approximately 70 percent of that amount, have in only 1 year since 1952 shown a loss on real estate loans, of as much as $1 million.

The report of the Federal Home Loan Bank Board on earnings of insured savings and loan associations does not set out specific figures reflecting losses experienced by savings and loan associations. One can only conclude that any loss experienced by these associations is set out in an item known as nonoperating charges. The total of such nonoperating charges does not in any year in the past 10 years amount to as much as 1 percent of their net earnings. In 1960, with a net income of $2,743 million—before dividends—their total nonoperating charges amounted to $9,566,000, or considerably less than one-half of 1 percent. The loss experience of these associations from the commencement of their operations in the early 1930's does not vary greatly from the loss experience cited in 1960.

To return to my own State of Georgia, the 67 insured savings and loan associations operating in this State have now accumulated total resources of over $1 billion. They have set aside as reserves and surplus an amount in excess of $84 million, or a ratio of reserves to total resources of over 7 percent. Their total mortgage loans, as of December 31, 1960, amounted to $902 million. Applying their accumulated reserves to their total loans, you will find they now have a reserve ratio against loans of over 9 percent. These figures compare favorably with the ratio of the total capital structure of banks to their total resources. The great difference being that the capital position of banks has been accumulated after paying full Federal income taxes, while that of savings and loan associations has been accumulated after paying practically no Federal income tax.

It would seem to me these mutual lenders have attempted to build a smokescreen, claiming that the effect of taxation will force them to reduce dividends and thereby slow down the flow of savings into mortgage channels. I hope you gentlemen will keep in mind the fact mutual savings banks and savings and loan associations are not the only source of mortgage loans. In fact, I know from experience there is no phase of the business of making loans more competitive at the present time than that of the mortgage loan business.

As to fair taxation forcing them to reduce dividends, their profit statement for 1960, as well as for previous years, does not bear this out. Again, in my own State of Georgia, the 67 insured savings and loan associations had net earnings of over $43 million. They paid in dividends over $34 million, leaving an amount of over $9 million transferred to reserves. Had their net earnings of over $9 million, after dividends, been subjected to the same average rate of Federal income tax (40 percent) as that paid by stock banks, their total Federal income tax would have amounted to slightly over $3,700,000. This would have left over $5 million to be transferred to reserves, and this without reducing dividends. This amount, together with

reserves already accumulated, would be entirely adequate to take care of any anticipated losses.

While the tax bill which you have before you is the product of a long, and, I think, agonizing survey by the very fine gentlemen of the Ways and Means Committee of the House, I find it impossible to concur in the optional provisions for taxing mutual savings banks and other cooperative lenders. The provisions of the bill, as reported out by the Ways and Means Committee, practically assures these operations of paying Federal income tax on no more than 40 percent of their net earnings. I see no justification for this. The figures which I have cited certainly do not justify continuing their tax-favored position over other types of corporations.

Finally, may I say that while I am in business directly in competition with Federal savings and loan associations, my interest in this matter over a period of some 20 years now, is not prompted primarily by a desire to punish a competitor or to lessen the competitive advantage which he may have over me, but rather to secure a fair and equitable tax base.

It is true, as I think every other businessman would feel, I would like to have lower taxes. I certainly do not ask though, that any tax reduction accorded me be at a cost to the rest of the taxpaying body.

Now, Mr. Chairman, if I may, and very unhappily, I would like to contradict a statement—I guess contradict is the correct word—made by Mr. Tark, a member of the executive committee of the Bankers Committee for Tax Equality. If you will indulge me, I would like to go back a little bit into the history in that organization. I would certainly like to clear it up for the benefit of Senator Byrd, the chairman. I am sorry he is not here, and I am sorry Senator Douglas is not here.

There is no membership in the Bankers Committee for Tax Equality. It is supported entirely by voluntary contributions. Those contributions are the result, I would say, 100 percent due to interest in the purpose for which the Bankers Committee was created, and that was to secure tax equality, between mutual lending institutions and commercial banks.

Senator BENNETT. May I stop you at this point?

Mr. GORMLEY. Yes, you may.

Senator BENNETT. There are no dues?

Mr. GORMLEY. There are no dues. It is a voluntary contribution.

Senator BENNETT. And the voluntary contributions may and do differ from one bank to another?

Mr. GORMLEY. Yes, sir. Let me go back. This committee was set up approximately 10 or 12 years ago. It met with quite favorable reception because none of the other banking groups would interest themselves in the matter of tax equality, for very good reasons. The Bankers Committee was organized solely for the purpose—I am glad Senator Douglas is back——

Senator BENNETT. Off the record.

(Discusion off the record.)

Mr. GORMLEY. Mr. Chairman, shall I go back and begin at the beginning of this testimony for Senator Douglas' benefit?

Senator BENNETT. May I explain, Senator, that Mr. Gormley has finished his prepared text and he is now commenting on the tax equality group.

Senator DOUGLAS. Very good. I have a copy, I think, of the testimony.

Mr. GORMLEY. You are at liberty to ask me how I feel about tax equality, too, when I finish, Senator Douglas.

I made the statement a few minutes ago to these gentlemen that the Bankers Committee for Tax Equality has no membership as such. There are no regular dues, it is supported entirely by voluntary contributions, some years one bank will contribute, some years another. I would say that the 6,000 bankers Mr. Tark referred to is made up of a list of bankers which, during the continuing period, at one time or another have contributed to the Bankers Committee. Those contributions came in solely because the Bankers Committee was organized primarily and only for the purpose of securing tax equality between mutual savings banks and Federal savings and loan associations and commercial banks. It was never contemplated that it would be a permanent organization. Once tax equality is accomplished, the Bankers Committee is out of business; there is no place for it at all, whatsoever.

I served as a member of the executive subcommittee, and Mr. Tark and I were the two sole members of that committee for a long time. We worked very patiently, very diligently, trying to accomplish the support of all the rest of the bankers' organizations in the United States.

I am going to give you some undercover secrets and tell you how withholding got into it and why I withdrew from the executive committee of the Bankers Committee for Tax Equality. Early in 1961, someone conceived the idea that if the Bankers Committee would come out and support withholding tax, the Treasury Department would recommend tax equality and that they would pass that recommendation on to the new President, Mr. Kennedy, and that he would come out for tax equality.

Senator CURTIS. Pardon me, at what level in the Treasury were they talking about in 1961 that was going to pass that on to the new President?

Mr. GORMLEY. That was since the new President came in. Incidentally, we had put all the pressure we could on Mr. George Humphrey, and through him, on President Eisenhower. We got a very vague recommendation from President Eisenhower. But that was this thing that brought the withholding tax into the bankers committee. It had no place in there. Someone conceived the idea that if we would come out for the withholding tax, that the President was very much interested in it and if we would support withholding, he would accommodate us by coming out for tax equality.

Senator CURTIS. This is very informative, because we have need for methods that bring success, sometimes.

Mr. GORMLEY. We went to the Treasury Department and paid a call on Mr. Surrey and either Mr. Wallace or Mr. Fowler. We very diplomatically approached them on this question of whether or not we would gain any ground if we were to come out and plump for a with-

holding tax. We were immediately stopped, and Mr. Wallace said, "Gentlemen, we are making no trades."

Senator CURTIS. When was this?

Mr. GORMLEY. That was in the early part of 1961, soon after the inauguration of Mr. Kennedy.

I realized that the bankers of the country were practically 100 percent opposed to the withholding tax. Whether they are right or wrong, Senator Douglas, is beside the point; let me finish.

I know the psychology of bankers. I have been in the business since 1910, in one phase or another. I attended the meetings of the ABA and the legislative committee——

Senator DOUGLAS. Did you say the ABA or the ADA?

Mr. GORMLEY. Senator, I am ashamed of you. I shall go the whole way and say the American Bankers Association.

This question came up in a meeting of the legislative committee of the ABA one afternoon, and it was shouted down. They would not allow it even to go to a vote. It came out in the executive council of the Independent Bankers Association the day we met here in Washington, and the day Mr. Kennedy sent his message to Congress in which he said that he thought mutual and cooperative lenders should be investigated with the idea of placing them on a comparable basis with other lending institutions.

The executive committee of the Independent Bankers Association would have voted 100 percent to condemn the withholding tax. I went before them and pleaded, "Gentlemen, please do not do this. The President has been nice enough to come out and support tax equality, and that is what we want."

Withholding tax is an unknown quantity, and I think, Senator, that is the reason why a degree of fear has developed among the bankers. We are all afraid of the unknown.

I shall say with regards to my own bank, and we are a 100-percent savings bank—we accept no checking accounts at all. We are a stock savings bank, but we do a savings business by election, and we pay a 52-percent Federal income tax. This matter of withholding has been considered by our board for the last two or three meetings. We, in our own minds, concede the withholding tax is going to pass.

Senator DOUGLAS. You think it is going to pass?

Mr. GORMLEY. Yes, sir; that is our feeling about it.

Senator DOUGLAS. Well, I hope you are right.

Mr. GORMLEY. We have already made plans as to how we shall handle this thing. Frankly, I look forward to withholding with a great deal of apprehension. That is about the best thing I can say. I do not know how the mechanics of the thing is going to be enforced. It seems to me the further we go with the bill, the more complicated that it becomes. When it was first proposed that we have a 20-percent withholding tax, it seemed to me that as far as the mechanics of the thing were concerned it would be simple. We have around $14 million of deposits. We paid out last year around $390,000 interest, approximately $400,000—we can figure 20 percent of that and send the Treasury Department $80,000. And as far as collecting the tax and remitting it our chore would be done.

But what the public effect of that is going to be on my deposits is an unknown quantity. We are an old institution and we have a lot

of very nice old ladies who are depositors that are interested in this and they are as curious as all outdoors.

Senator DOUGLAS. Mr. Gormley, I think the apprehensions are uncalled for, because all that will happen will be that there will be deducted the entire amount paid out in dividends and there will be no listing of individuals or the amounts they receive or their addresses.

Mr. GORMLEY. You make it sound so easy.

Senator DOUGLAS. The vast majority of these people owe these taxes, and there will be no overwithholding on them. Those who do not owe taxes can get it refunded quarterly.

Mr. GORMLEY. I think there is some meat in what you say. At the same time, it seems to me that when you undertake to break these interest payments down into classes, people in a certain age bracket, and trust funds, you complicate the procedure——

Senator DOUGLAS. Well, you know, the House put those in at the suggestion, really, of the bankers, and now that they are in, the bankers are saying this makes it too complicated.

Mr. GORMLEY. I am not conscious of that. It seems to me they make it more complicated. But the point I want to make is, Mr. Tark, and he is a very dear friend of mine, does not, and neither does the bankers' committee, represent 6,000 bankers. I do not think the bankers who have contributed to the bankers' committee through the years would support Mr. Tark in the position he takes, and I think I know the bankers as well as if not better than Mr. Tark, because I deal with every class. I was superintendent of banks in Georgia for a good many years, and I know the bankers' temperament. Again, I think a good deal of the problem may be because we are afraid of it. It is an unknown quantity.

I do not support withholding because I know our membership is not in favor of withholding, and I think they will condemn it. You have a few holier-than-thou bankers who will say, "Yes, this thing should be paid." Nobody disputes that; it should be paid.

And I say this to you, if there is no other way of collecting it except by withholding, we are going to swallow the pill. We shall go along with it.

Senator DOUGLAS. I take it you are not so much opposed as apprehensive.

Mr. GORMLEY. I think that is probably true.

Senator DOUGLAS. We want to dissipate your apprehension.

Mr. GORMLEY. Senator Byrd was correct when he said the letters he is getting from the bankers are 100 percent practically opposed to this. I say that the bankers committee cannot solve the ills of the Government here, as much as we would like to, and we cannot constitute ourselves as a body to try to reform the taxpaying habits of the American people. We have some tax problems, I admit, but I am in the savings bank business and, by and large, my depositors come to me each year and ask for a statement of the interest they are paid so that they can return it in their Federal income tax statement.

I say this again, if withholding comes, it is going to be like taking a dose of castor oil. We shall take it, but we will not take it good, Senator.

Senator DOUGLAS. May I say this, since you have spoken of President Kennedy, may an uninfluential Member of the Senate make a statement on this matter, that if the bill should end up without withholding but with the investment credit, some of us will be tempted to go against the whole thing, and then there will be no approach to tax equality as between banks and savings and loan associations.

Mr. GORMLEY. With all due respect to the Senator from Illinois, I say that would be sadly lacking in statesmanship, and we like to look upon you people as statesmen.

Senator DOUGLAS. This is the sugar which we place in the castor oil.

The committee will be adjourned until tomorrow morning at 10 o'clock.

(By direction of the chairman, the following is made a part of the record:)

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION OF MERIDEN,
Meriden, Conn., August 11, 1961.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: The attempt to change the tax status of the savings and loan business is not prompted by any thought to bring about any equity in taxation. By using the Federal Reserve and Treasury Department (which the American Bankers Association influence to a large degree) the commercial bankers have been trying for years to eliminate a factor in the financial structure of our economy which they believe is rendering a service to the American public that the commercial banks have never served, nor would they be willing to serve this great middle income group of homeowners and savers if they had the opportunity.

In the first place, this is not a White House recommendation but is a report of Secretary Dillon with submittal letter dated July 14, 1961. While the savings and loan business does not deny the probable need for Federal income, we do know that the suggestions contained in this report are not by any stretch of imagination going to aid our economy. This proposal will, on the contrary, have a very adverse effect on the housing and home building in this country, not to mention the shrinking of savings which millions of thrifty people have placed in savings and loan and savings banks.

At present 7 million homes are being financed by savings and loan associations. Last year 45 percent of the homes bought or built in this country obtained their financing from savings and loan associations. A change in the present tax status would, without question, make it mandatory for dividends to be dropped by about one-half percent and this would create a shortage of mortgage money in the main stream of home financing and, obviously a smaller supply of money means a higher mortgage rate as the need for mortgage money will not be proportionately reduced. The homebuilding business is one of the principal props of national prosperity and proposed change in tax status could reduce money available for this purpose by $5 billion in the next year.

In 1950 the commercial banks financed 21 percent of home purchases, in 1960 they financed 15 percent. Commercial banks lend their money on whatever is the most profitable, and do not provide a consistent source for mortgages. Compared to the 45 percent financed by the savings and loan associations with 15 percent by commercial banks, wouldn't this bill result in crippling the homebuilding industry?

In Connecticut last year our business was owned by some 340,000 people that had saved their money and had an average account of $1,789 on which they are receiving an annual income of about $60. During this same period these savings and loan associations placed $110,361,000 into financing the acquisition of homes by people of the State—these figures may be more than doubled when savings banks are taken into consideration. If we were forced to pay the full 52 percent corporation tax this would have an adverse effect on the homebuilding industry in the State and would also deprive citizens of modest means from owning their home. In Meriden, the First Federal Savings & Loan Association based on 1960 figures would be affected thusly: Net earnings would have been reduced from $144,000 to $69,000. On the basis of the 10 percent reserve regulation which would have required $98,000 to reserves we would have been unable to meet this by some $20,000 and the result would have been a reduction in dividend; our present dividend rate is 3½ percent which is less than many in other sections of the country. A change of this sort would have affected some 23,000 shareholders with average accounts of $1,179 and would, in all probability, require that we raise the mortgage interest rate, which is entirely contrary to President Kennedy's efforts by his own request to the Federal Home Loan Bank Board.

The savings and loan business in the United States presently represents assets of $75,200 million and because of growth since the depression year it has been difficult for all of these associations to attain the required degree of reserves required by regulation, while at the same time maintain a reasonable competitive dividend rate, and the industry no doubt will be faced with this situation for some time to come. Mainly, growth has been created by the efforts of management of these institutions to render a wider and better service to that great section of our population which works for a weeks salary and wishes to save a few dollars for a rainy day while trying to acquire a home of their own. This is a section of our population which the commercial banks have only recently tried to cultivate in their public relations efforts. Surely our elected representatives in Washington do not want to stand by while big business in the form of commercial banks and the American Bankers Association deprive these people of this service under the guise of assisting our Government in raising revenue.

The fault lies here. You don't raise money for a short-term crisis by dismantling a long-term investment business by which this country has achieved 60 percent homeownership—the highest in the world. Furthermore, this matter should not be considered as part of an overall tax bill. This is a long-term permanent charge; if it goes through you will substitute one crisis for a recession. You should also realize that commercial banks paying 3 percent initiated this idea and there is some danger of a war psychosis being used to pass the bill. Just don't let it happen. The country is in no position to experience a major economic upheaval, particularly to satisfy the whims of a group of greedy persons who consider it their prerogative to handle all of the financial problems of the United States.

If you study the bill sufficiently, the facts will give you the answer I request, I am certain.

Yours very truly,

H. DUDLEY MILLS,
President.

OAKLAND, CALIF., *March 30, 1962.*

Senator HARRY F. BYRD,
Chairman, Finance Committee of the Senate,
Washington, D.C.

DEAR SIR: During the course of hearings by the Ways and Means Committee of the House, a great deal of publicity was released by the building and loan industry seeking to influence legislation regarding the realistic taxing of this type of organization.

Due to my preoccupation as a certified public accountant at this time of year I did not have the opportunity at the time to bring certain factors of this subject to the attention of the Ways and Means Committee.

I am enclosing photographic copies of Standard Listed Stock Reports dated January 12, 1962, No. 891, and of the reported earnings of the First Charter Fi-

nancial Corp. published in the Wall Street Journal, Pacific coast edition, March 27, 1962.

I think by study of the enclosed it will be quite evident that substantial benefits because of the favored taxation position have flown to speculators and not the small mutual fund savers nor the homeowners who have made borrowings from this type of organization.

Among the items I direct your attention to in respect to one I have chosen for illustration purposes, i.e., First Charter Financial, is the evident fact that First Charter Financial is paying no Federal income tax for its operations and its numerous subsidiaries for the year 1961 but rather will be seeking an operating loss carryback or credit of $41,673. You will also notice that this is despite having income before income taxes for 1961 of $16,856,474. The apparent reason is that they have been able to credit $16,590,796 to their reserves (apparently bad debt reserve) under the 12-percent rule. You will also notice that despite income of the 2 prior years from in excess of $10 million and in excess of $13 million their total income taxes for the 2 years were below $210,000.

Now who has been the beneficiary of this type of a situation? (And please bear in mind that according to Standard & Poor's there were at least 18 other savings and loan holding companies.) It is the owners of the common stock of this type of holding company that have been made multi-multimillionaires. Here we find a book value, as an illustration, of $10 per common share at December 31, 1961, and we find that the stock during 1961 sold on the New York Stock Exchange at a range of $69 high to $28.625 low and a recent quotation of $44 to $45.

You will further find that one man owned approximately 50 percent of the over 6 million shares of the stock outstanding and if you will check the Securities and Exchange Commission files you will find that approximately 3 million shares have been sold in recent years out of his wife's estate. His remaining holdings at $44 to $45 per share at present market value figure up to be worth $140 million.

I believe that if you were to have the Treasury Department check into the files of the S.E.C., the individual taxpayer and the holding company that you would find the cost of this stock was comparatively nominal, let us say, about $2 to $3 a share.

There are many other factors that are disturbing in regards to the extent these holding companies have been engaged in speculation but that is not pertinent to this matter.

There may be a substantial number of building and loan associations and mutual savings banks that are still truly mutual. Legislation certainly should differentiate between such organizations where the plus earnings inure to the benefit of depositors from those where these tax benefits solely inure to the benefit of speculators.

Sincerely yours,

D. A. SARGENT.

FIRST CHARTER FINANCIAL

First Charter Financial Corp. and subsidiaries: Pamphlet report for the year ended December 31:

	1961	1960	1959
Earned per share [1]	$2.46	$1.89	$1.50
Total income	60,416,415	46,773,633	34,572,050
Net before income taxes, etc	16,856,474	13,110,255	10,450,250
Federal income taxes	[2] 41,673	87,887	120,814
Minority interest	38,349	31,969	30,236
Net income before reserve appropriations	16,859,796	12,990,399	10,299,200
General reserve appropriations	16,590,796	11,806,290	10,188,023
Balance after reserve	269,002	1,184,109	111,177

[1] Based on net income before appropriations to general reserves and on the 6,860,175 shares of capital stock outstanding at close of 1961.

[2] Credit.

Balance sheet items of First Charter Financial Corp. and subsidiaries as of December 31:

	1961	1960	1959
Total assets	$985,460,313	$769,051,235	$597,913,633
Cash	7,802,106	4,190,928	12,844,774
Government securities, etc	52,897,914	68,371,394	50,661,643
Loans receivable	876,501,238	669,748,120	509,706,720
Savings accounts	748,037,707	587,529,804	457,014,204
Federal Home Loan Bank advance	118,115,777	69,223,360	50,861,132
Bank notes payable	3,000,000	21,250,000	9,060,000
Undisbursed loan funds	22,527,492	25,400,931	21,034,469
Paid-in surplus	31,457,798	10,159,702	2,805,327
Undivided profits and general reserve	42,031,621	44,118,973	38,585,449
Capital shares	6,860,175	6,457,500	6,150,000

First charter financial [1]

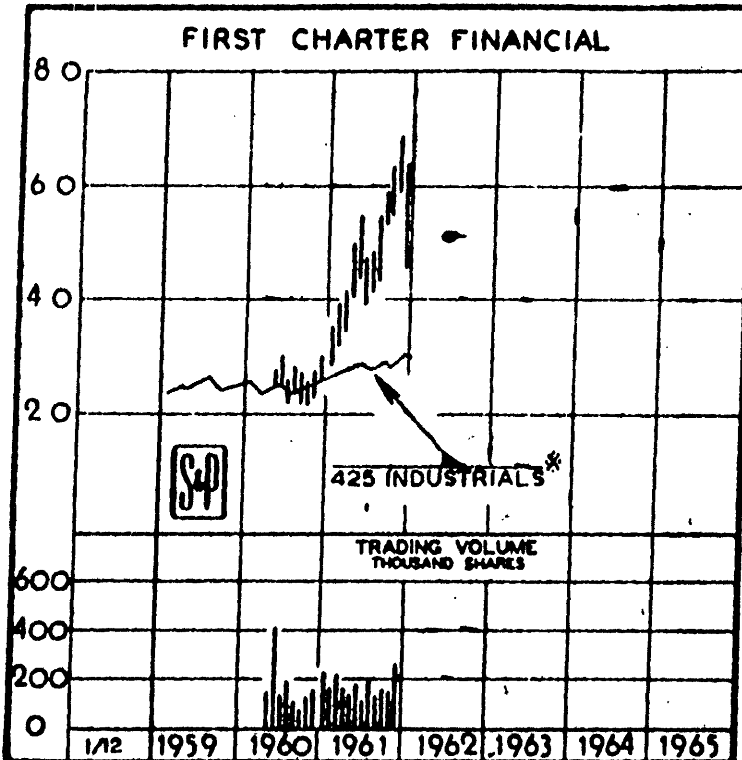
Stock—Common:

Approximate price	47⅛
Dividend	(2)
Yield	(2)

[1] Listed N.Y.S.E. & Pacific Coast S.E.; also traded Boston S.E.
[2] Paid 5 percent in stock on Dec. 8, 1961.

RECOMMENDATION

Owning six savings and loan associations with 43 offices in the San Francisco Bay and Los Angeles areas, this holding company is favorably situated to take advantage of further growth in population and home building projected for California over the years ahead. The more immediate outlook, however, is clouded by possible adverse tax legislation and by possible consequences of recent increase in interest rates on savings deposits by the competing commercial banks. The shares have recently fallen off sharply following a steep rise, and there may be a further period of irregularity until immediate uncertainties are cleared.



* Charted on special comparable scales; values not shown.

Common share earnings

Quarter	1961	1960	1959
March	$0.46	$0.37	$0.35
June	.63	.57	.45
September	.56	.54	.40
December		.60	.50

In the 9 months ended September 30, 1961, net earnings (before appropriations to general reserves) rose 19 percent from those of the corresponding period a year before. The smaller gain in share earnings, to $1.65 from $1.48, reflected the larger number of shares outstanding. Loans outstanding as of September 30, 1961, were 28 percent above the year-earlier level, and the same percentage increase was recorded in the amount of savings. Mortgage rates for the 9 months averaged 6.77 percent. The third quarter figure was lower, averaging 6.64 percent, but this was still above the 6.44-percent average return on the entire mortgage portfolio as of the end of 1960.

DIVIDEND DATA

The company's present policy is to pay dividends in stock once a year prior to the year end. The payment in 1961 was:

Amount of Dividends Stock	5 percent
Date Declared	Sept. 27
Ex-dividend Date	Oct. 17
Stock of Record	Oct. 20
Payment Date	Dec. 8, 1961

PROSPECTS

The earnings outlook for 1962 depends importantly on what changes, if any, are made in tax legislation and in the interest rate paid on savings accounts. If there is no change, earnings should score another good gain over the $2.25 a share estimated for 1961. The latter compares with $2.01 (on fewer shares) a year before. Dividends are expected to continue in stock; a 5-percent distribution was made on December 8, 1961.

Existing tax legislation, under which savings and loan associations are enjoying tax-free status by transferring all their earnings to reserves, is likely to be reviewed by Congress in 1962. What form any changes will take is unpredictable, but there is general feeling that some cuts will be made in the present tax advantage. One proposal calls for a stepping up in taxes over a period of several years, at the end of which all of the present tax advantage would be eliminated.

As permitted by recent new regulations, major commercial banks in California have raised the interest rate on savings deposits from 3 percent to 3½ percent, and to 4 percent on deposits left with the banks for a year or more. Savings and loan associations have been paying 4½ percent. The lower spread may cause a slowdown in the flow of savings to the associations. If the associations in turn raise their rates, expenses will rise, although compensating increases in mortgage rates should eventually provide an offset.

RECENT DEVELOPMENTS

Three offices were opened in 1961; in the preceding year, two branches were added. During 1961, the branch modernization and enlargement program was substantially completed; 11 offices were enlarged and modernized or moved to completely new buildings in 1960, and in 1959, 19 offices were modernized or enlarged.

Management recently stated that it has had proposals to extend its operation into other related fields and is investigating these possibilities.

Income statistics (million $) and per share ($) data [1]

Year ended Dec. 31	Revenues	General expenses	Interest expense	Net before taxes	Including taxes	Net earnings	Common share (dollar) data		
							Earnings [2]	Dividends	Price range
1961 [4]								(4)	69 -28⅝
1960	46.8	9.4	24.3	13.1	0.09	13.0	2.01	(4)	30¼-15¼
1959	34.6	7.2	17.0	10.5	0.12	10.3	1.67	(3)	22 -15½
1958	26.3	5.1	12.9	8.3	0.05	8.2	1.37		
1957	21.5	4.2	10.1	7.3	.04	7.2	1.20		
1956	15.3	3.8	6.7	4.8	.02	4.8	.80		
1955	13.0	2.9	5.3	4.8	.04	4.7	.79		
1954	8.7	2.2	4.0	2.5	.03	2.5	.42		

[1] Pro forma in 1958 and prior years.
[2] Before appropriation to general reserves.
[3] 2½ percent in stock.
[4] 5 percent in stock.

Pertinent balance sheet statistics (million $) [1]

Dec. 31	Total assets	Savings accounts	Cash and governments	R.E. loans	Capital funds and reserves	Loans (X) capital funds and reserves	Dollar book value common shares	Price (X) book value	
								High	Low
1961 [2]	833.9	665.0	55.9	736.1	66.1	11.1	10.11	6.8	2.9
1960	769.1	587.5	72.6	666.7	56.4	11.8	8.71	3.5	1.8
1959	597.9	457.0	63.5	509.7	43.4	11.7	7.06	3.1	2.2
1958	453.6	355.8	48.0	388.4	33.3	11.7	5.54		

[1] Pro forma in 1958 and prior years.
[2] As of June 30.

Fundamental position

First Charter Financial is the second largest of 10 savings and loan holding companies whose stocks are publicly held. It owns 6 savings and loan associations operating 44 offices located in the San Francisco Bay and the Los Angeles areas. The number of offices is the largest of any such holding company. The aggregate savings held amount to about $712 million.

Three savings and loan associations operating 29 offices in the San Francisco Bay area account for roughly 60 percent of the total savings, while three other associations with 15 offices in the Los Angeles area contribute 40 percent.

Pioneer Investors Savings & Loan Association is the largest in its field in northern California and 15th largest in the country, operating 15 offices. American Savings & Loan Association, with 13 offices in the Los Angeles suburbs, is 19th largest in the country and 6th largest in southern California.

Other associations owned are Berkeley Savings & Loan Association, with nine offices in east San Francisco Bay communities; Home Mutual Savings & Loan Association, five offices in San Francisco; Mutual Savings & Loan Association of Alhambra and Lancaster-Palmdale Savings & Loan Association, each with one office. All of the associations are wholly or 99 percent-owned except for the 53 percent-owned Lancaster-Palmdale Savings & Loan, whose accounts are not consolidated. Except for the Lancaster-Palmdale unit, which was established in 1954, the associations date back to between 1885 and 1927.

These associations derive substantially all their earnings from real estate loans made with funds obtained from depositors. Of total loans outstanding, approximately 50 percent are conventional loans, 36 percent insured by the Federal Housing Administration or partially guaranteed by the Veterans' Administration, and 11 percent short-term construction loans.

For the greatest part, loans are on single family residences in metropolitan areas. Excluding the construction loans, the average original size of loans is about $10,500 and the average original repayment period is about 20 years. Construction loans are made to homebuilders and are paid off upon completion and sale of the individual houses, usually in 9 months.

As of June 30, 1961, the average rate of return on the loan portfolio was 6½ percent. The savings and loan associations pay 4½ percent interest on the savings accounts.

Under present regulations, savings and loan associations enjoy an important tax benefit in that earnings may be transferred to reserves without liability for Federal income taxes. This may be done until such time as the sum of surplus, undivided profits and reserves at the beginning of the year equals to 12 percent of savings accounts at the end of the year. Based on savings as of December 31, 1960, the applicable percentages for the company's associations averaged about 9 percent. Earnings so appropriated are not available for payment of cash dividends or for distribution to stockholders at a later date without being subject to taxes.

Besides the six savings and loan associations, First Charter Financial also owns six insurance agencies, two trustee companies and two real estate brokerage companies. These account for only 1 percent total earnings.

Earnings-dividends

Reflecting robust homebuilding activities in California and rapid growth in savings funds, earnings rose some 175 percent in the 5 years through 1960. This was a compound annual growth of 22½ percent. Savings accounts rose 258 percent in the 5 years. Because of tax benefits, substantially all earnings of the subsidiary association are transferred to reserves. Dividends by the parent holding company thus have been in stock only.

CAPITALIZATION

Common stock: 6,533,500 shares (no par); 50 percent owned by S. M. Taper, president, and the estate of his deceased wife.

NATIONAL ASSOCIATION OF
STATE SAVINGS AND LOAN SUPERVISORS,
April 6, 1962.

The Honorable HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I am writing this letter as chairman of the Legislative Committee of the National Association of State Savings and Loan Supervisors, in reference to bill No. H.R. 10650, passed recently by the House of Representatives, and presently being considered before the Senate.

On August 10, 1961, during my term of presidency of this association, I appeared before the House Ways and Means Committee in opposition to any proposed change in Federal taxation which would prevent associations from making additions to general loss reserves, tax free, until the aggregate of general reserves and undivided profits of savings and loan associations exceeded 12 percent of the association's share capital.

If you will refer to the proceedings before the House Ways and Means Committee of August 10, 1961, you will note that my opposition to any change in the tax law was based on my personal knowledge and experience over a 30-year span of savings and loan supervisory activity in the State of Wisconsin. I have stated that losses during the depression period closed 76 associations for the reason that at the beginning of the depression the average of reserves to share capital of these associations was but 2½ percent. In some instances, it was necessary to charge losses as high as 52 percent of the member's share investments.

In 1951, the Congress had seen fit to select the adequate reserve level as 12 percent of the association's share capital, before such association would be subject to a Federal income tax. Mortgage loans, being for a long period of time, are subject to many economic changes. Losses on real estate, securing long-term mortgage loans, would be much greater than the losses sustained by a banking institution on short-term loans. For that reason, savings and loan associations should be afforded the opportunity to build tax-free reserves under the 12 percent formula of 1951 to prevent future hardships and suffering that might occur during a major recession or depression.

On January 30, 1962, the Treasury Department recommended a tax formula for savings and loan associations which was so severe and drastic that it would have ruined the savings and loan business—the major home financing agency of the Nation.

Bill No. H.R. 10650, passed the House of Representatives by a vote of 219 to 196, proposes to tax savings and loan associations on 40 percent of net income, after expenses and after dividends. This proposal, if enacted into law, would not severely harm the savings and loan associations, but would restrict their operations to a great degree. In my opinion, the imposition of a tax at this time, would increase loan costs to the borrowers in order to maintain the periodic reserve increases imposed by law and supervisory authorities of savings and loan associations.

If the Senate feels that the 60–40 formula, as proposed in bill No. H.R. 10650 is just and equitable —and in my opinion anything less than this would be unjust and inequitable—then I believe the tax formula proposed by the Senate should contain a proviso which would spread the impact of higher taxes paid by savings and loan associations over a period of several years. A phase-in period of 3, 4, or 5 years would permit associations to adjust their operations in an effort to meet the higher tax burden.

A savings and loan association can build reserves only out of income. Savings and loan supervisors and commissioners are charged with the responsibility of knowing that the associations they supervise and control have adequate reserves in order to assure the public that they are doing business as safe and sound institutions. If at some future time it becomes imperative to close associations for the reason of insufficient reserves, and the major factor contributing to such a situation was the imposition of tax formula which prevented such associations from building adequate reserves and still furnish funds for economical home financing, the matter will come back to Congress for rectifying and will then be very grave.

I therefore respectfully request, on behalf of the National Association of State Savings and Loan Supervisors, that you and the other members of the Senate give bill No. H.R. 10650 your most serious study and analysis to insure that any proposed tax change be of such degree as to enable savings and loan associations to continue to supply the major portion of funds to provide economical home ownership for the American public, and continue to operate as safe and sound institutions by building and maintaining adequate reserves.

Respectfully submitted.

R. J. WINKOWSKI,
Chairman, Legislative Committee.

TWIN FALLS BANK & TRUST CO.,
Twin Falls, Idaho, April 3, 1962.

Hon. FRANK CHURCH,
U.S. Senate Office Building, Washington, D.C.

DEAR SENATOR CHURCH: I wish to thank you for all the time and effort which you and the other Idaho members of the 87th Congress have put forth in the interests of the commercial bank case for tax injustice between commercial banks on the one hand and Federal savings and loan and mutual savings banks on the other hand.

May I also convey through you sincerest appreciation to Chairman Wilbur Mills and his House Ways and Means Committee for their tireless effort over an extended period of time not only on this facet of taxation, but also on a multitude of other tax matters.

As you know, the current tax bill passed the House last Thursday by a vote of 219 to 196 following the President's special appeal for the need of increased revenue fortifying previous requests that tax loopholes be closed.

I am deeply moved, along with other Idahoans, by the current trend of Government action being proposed for consideration by the U.S. Congress as well as current trends on proposals that appear to have as their objective the by-passing of Congress on matters affecting our daily lives and the welfare of the country. This movement is not of recent origin. But again in the name of social welfare the tempo is being stimulated to a crescendo. I urge that you be calm in your deliberations and steadfast in your convictions in what is right and fair in the longrun best interests of the people you are privileged to represent.

We must provide the necessary funds for adequate defense of our own country in addition to the normal functions of the Central Government, and provide

it through taxation in peace and cold-war time on a fair and equitable basis and not by chronic Federal deficits.

I wonder just how much more socializing of the voters of this country the American taxpayers can pay for or get credit to carry by monetizing the public debt or how much more unfavorable balance of trade debt this country can work out from under. We are witness to these conditions rapidly progressing today, when our Government to be solvent needs tax money as never before, outside of the time of a shooting war.

The Federal savings and loan associations, however, along with the mutual savings banks—a combined $110 billion industry of the country— have for years enjoyed virtual Federal tax immunity. These organizations now under the present House tax bill are to be taxed under certain conditions unless it works a hardship, at not more than 40 percent of the effective rate at which commercial banks are taxed. The commercial banks of the country, for the year 1960, paid in Federal taxes 35 percent of their net income before taxes while Federal savings and loan associations paid only eight-tenths of 1 percent in the same year. This comes from documented information. What do the Federal savings and loan associations and the mutual savings banks have that other competing financial institutions such as commercial banks do not have that permits this double standard of taxation which has existed for so many, many years? Could it be the influence of a Washington lobby on the outside with over 100 industry-interested trojan horses in the Congress, both of which groups conscientiously believe that the cost of Government which furnishes them with the same protection of the Army, Navy, and Air Force as well as all other Government services that are furnished to all Americans, should be paid for by taxpayers other than Federal savings and loan associations and mutual savings banks. Again may I ask why the double standard of taxation.

President Kennedy has twice requested, and former President Eisenhower requested, that this tax loophole be closed; the closing of which, it has been estimated, would provide the Government with from $500 to $600 million additional annual revenue. It should be borne in mind that there is common cause by the Federal savings and loan associations and mutual savings banks in resisting a change in the law to fully tax them on the same basis that commercial banks are taxed. It may not be obvious to you that there are many bankers that are not simon-pure for the reson that they, too, are connected with Federal savings and loan associations in official capacities and that there are still other commercial bankers who have been hesitant to raise their voices on the side of tax justice for the reason that substantial cash balances are maintained in their respective banks by certain Federal savings and loan associations.

In 1960, when I was president of the State bank division of the American Bankers Association, I suggested to a fellow officer of another bank division that I believed that a resolution should be drafted providing that no commercial banker should be eligible to serve in a top official position of the American Bankers Association who at any time was connected, directly or indirectly, with the Federal savings and loan associations. I was immediately and frankly informed that the member I was speaking to would be embarrassed under such a condition for the reason that he himself was strongly identified with Federal savings and loan associations.

I am only conveying these observations in order that you may be cognizant of the divergent interest not readily identifiable and by which you might be misled. I do wish to emphasize and want you to understand and know that I have confidence in the present top officials of the American Bankers Association as being truly representative of commercial banking. I also wish to assure you that the American Bankers Association officers and staff are dedicated career men of highest integrity and well informed. These men are truly carrying the fight for tax equality in the highest tradition of American banking to the end that this tax inequality between competing financial institutions be placed on a par and that out of the process the Government will obtain the revenue to which it is justly entitled. In their annual meeting in June 1961, the Idaho Bankers Association unanimously passed a resolution supporting the principle of equal Federal taxation between competing financial institutions.

The present House-passed tax bill permits a terrific watering down of the Ways and Means original concept for at long last taxing the Federal savings and loan associations and mutual savings banks $110 billion segment of American industry. This House passed concept of permitting 60 percent of the earnings to go through the sieve untaxed is paralleled by at the same time requesting banks

and others to act as tax collectors by withholding taxes on interest and dividends at the source. I ask in all good conscience does it not appear that many Members of Congress do not trust the American taxpayer and does it not appear that the American taxpayer will not long trust such Members of Congress?

It was a close vote in the House on this tax measure. I do not know what the outcome may be in the Senate but the entire Idaho delegation outside of the Senators themselves can be an influence in that Chamber. I solicit the assistance of all of you to the end that the House-passed tax bill may come back for amendment to a joint Senate and House Committee out of which process I earnestly hope that on this question of tax uniformity that the provisions of the present watered-down House bill be amended and fortified to fully tax our competing industry and that further in this process you delete the provision making tax collectors out of the banks and others on interest and dividends under the present House-passed bill. As it appears to me, the present bill only requests at the maximum some 40 percent of what is estimated to be between $500 and $600 million possible annual revenue if Federal savings and loan associations and mutual savings banks were taxed on a par with commercial banks and then on the other hand to in a meaure compensate for this gratuity and based on the assumption that the American taxpayer is honest, to retrieve under gestapo methods the tax money thought to be possibly lost from supposed tax dodgers. This all seems to be the height of inconsistency and not in true American tradition. This is rather, I believe, a concept fostered abroad and should be labeled as an import.

I want you to feel free to call collect or write to me on any point on which you may think that I may be helpful in giving you facts on which to base your decisions.

I have faith and confidence in your judgment and I am proud of our Idaho delegation. Again, with much appreciation for your tireless efforts, I remain,

Sincerely yours,

HARRY EATON, *President.*

FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION,
Chicago, Ill., March 9, 1962.

HON. THOMAS B. CURTIS,
House Office Building,
Washington, D.C.

DEAR REPRESENTATIVE CURTIS: As you know through the years, I have spent a great deal of study and time on legislation helping create, improve, and protect the modern mutual savings and loan program. Of all my experiences in Washington, I treasure most the confidence the Banking and Currency Committee had in me in the years I was working on credit union and savings and loan legislation. I helped write the original Federal Home Loan Bank Act, was an appointee of President Hoover on the original Federal Home Loan Bank Board, helped do the Home Owners Loan Corporation Act which included the legislation for Federal mutual savings and loan charters, participated in drafting the Federal Savings and Loan Insurance Corp. legislation (the FDIC for savings and loans), did the section in the Servicemen's Readjustment Act of 1946 for Senator McFarland and Representative Cunningham (incidentally, the ABA opposed savings and loans participating in this program). I have worked on savings and loan matters since 1926. In fact, I took a very active role in 1951, when Congress last amended the revenue statute dealing with domestic building and loan associations and enacted the 12 percent reserve for bad debts.

I am shocked that the Ways and Means Committee would go along with withholding at the source on earnings on savings accounts, such as savings and loan association savings accounts, when the Treasury Department itself estimates that the total dividend from stocks is $10.6 billion, and only 8.8 percent is not reported. In the mutual savings banks and savings and loan associations, I estimate there are $5 million in interest and dividends, and the nonreported percentage is about the same as the Treasury figures for stocks. Certainly this calls for further education and raises a question as to should we subject our savings customers to advance payments of taxes; subject us to the very large costs of administration of withholding; of explaining and dealing with all our savings customers and in my institution alone, we have 143,000 savers. We will have a great deal of irritations and resentment from our customers toward the Congress, the Treasury, and ourselves. Furthermore, you can ascertain from Treasury

officials that their new electronic data processing system, within the next 2 or 3 years, will pick up all of the dividends and interest on savings which are not reported and paid by the taxpayers. Again, the continued education program coupled with the electronic data processing system which is now being installed by the Treasury Department would, in a very short time, pick up the 8.8 percent unreported income from dividends and savings interest without the necessity of an expensive and cumbersome and irritating withholding system. We have sent the attached notice to all our savings customers at my First Federal of Chicago three times and our people report and pay.

Turning to the taxation of savings and loan associations, I am one of those who believe that the policies of the Congress have been fair and constructive and feel that you have given us a tax status as mutual savings and loan associations and mutual cooperative banks which has permitted us to reward our savers and serve millions of homeowners and homebuilders in a most constructive way. I have worked for years for the total exemption of mutual savings banks, mutual savings and loan associations and mutual credit unions, which has always been the policy of the Ways and Means Committee.

The initial question arose in 1894, when it was proposed to the Congress that a tariff bill there be a 2-percent tax levy on the net income of all corporations, including building and loan associations. The Ways and Means Committee exempted building and loan associations who make loans only to their shareholders in the State in which they are organized. The Senate Finance Committee recommended similar but slightly broader language to the effect that the exemption should apply to building and loan associations or companies which make loans only to their shareholders. The question of exemption arose again in connection with the stamp taxes in the Dingley Tariff Act of 1897, again in the War Revenue Act of 1898, again in the Paine-Aldridge Tariff Act of 1909, again in the first income tax law in 1913, again in 1914 in the emergency revenue law, again in the Revenue Act of 1916, again in the excess profits tax in 1917, and again in the Revenue Act of 1921. In all of this legislation, mutual associations or associations who made loans to their shareholders only, be they borrowers or savers, were exempted.

In 1921, an additional policy was established under the leadership of Ways and Means Chairman Joseph W. Fortney. In addition to preserving the principle of the prior exemptions from income tax, stamp tax, excess profits tax and capital stock tax, the Ways and Means Committee reported a $500 exemption on the income of individuals derived from mutual savings and loan shares. This was in order to assist the post-World War I housing shortage by making local long-term, amortized loans available in a greater amount through local or domestic building and loan associations. The $500 exemption was stoutly resisted by the commercial banks, and the Treasury and the Senate turned down the proposal. However Congressman Fortney and Congressman Longworth, leading the House conferees, prevailed in the conference and a $300 compromise exemption went into the law. This was continued until 1936, at which time friends of the savings and loan associations on the Ways and Means Committee, particularly Representatives Reed, Jenkins, Cullen, and Dingell, felt that we should not resist the recommendation of the Treasury and that this personal income tax exemption should be terminated. I was in charge of the United States League at the time, and their advice was followed and the personal income exemption was repealed without controversy or resistance from the savings and loan associations and cooperative banks.

I personally think that the mutual savings and loan business is now strong enough to pay a reasonable corporate income tax. I participated in the tax studies in connection with the development of the Revenue Act of 1951. Here again, the Ways and Means Committee stood firm for the traditional policy regarding mutual savings banks and mutual savings and loan associations. I thought that the conference compromise in 1951 would raise $75 million from the mutual savings banks and mutual cooperative banks and savings and loan associations. This did not materialize on account of the slow accumulation of reserves in mutuals, measured as a percentage of assets due to rapid growth. This rapid growth was of course very good for the national economy because it provided economical long-term mortgage credit to individuals in areas which otherwise would not be served.

The mutual savings banks who had higher reserves, percentagewise, paid little tax because of their substantial investments of assets other than mortgages in tax-exempt municipal bonds. There is no reason why these cooperative and

mutual institutions should not bear a taxload that is proportionate per billions of assets to what the committee expects from mutual casualty companies, or ultimately the formula for mutual credit unions. I do not have figures separating mutual life companies and stock life companies but I believe that the mutual savings and loans can pay a corporate tax of about half that paid in total by the life companies. Obviously, it must be less as the life companies do not distribute all their earnings to customers as we do in mutual savings and loans because my total figures include very profitable stock companies. Also life companies, stock and mutual, make very substantial profit from their underwriting activities and also from their investment activities. The mutual savings and loans, in the practical sense, have only investment income from Government bonds, property improvement loans and home mortgages. The new savings and loan formula should be worked out so that every institution pays according to its size, its net earnings, and therefore its ability. This, the present formula adopted by the committee, does not accomplish. The formula tentatively approved by the Committee on Ways and Means based only on growth would have caused thousands of institutions to pay 52 percent of net earnings after being forced to accumulate their statutory and regulatory reserve for losses, while hundreds of boom institutions in California and other areas would have gone scot free from taxes. The 60 percent alternative proposal helps this some, but as long as you leave the growth formula in the legislation, those savings and loans, however well managed, which do not grow rapidly, will pay all the taxes.

A much sounder program would be the deletion of the formula based upon growth and the provision of a single standard which would apply to all mutual savings and loans, mutual cooperative banks, and mutual savings banks of a reserve for bad debts measured by 75 percent of taxable income computed without regard to the reserve allowance. This would insure that the efficient, well-managed institutions in areas of the country which may not be rapidly growing will be accorded equitable treatment consistent with the earnings of the institution, and will insure the maintenance of financial strength and at the same time permit all mutual institutions to build up their reserves for losses that are required under Federal and State laws, regulations and requirements of the Federal and State supervisory authorities. In my opinion, such a single standard would not only be much more equitable than the present proposals, but would also yield a much more predictable amount of revenue, which would be approximately $150 million annually, if my recommendation immediately following that privately owned stock savings and loan associations be put on a "tax equality" basis with commercial banks is adopted. This 75-percent formula has been officially approved by the Legislative Committee of the National League of Insured Savings Associations.

I am personally shocked and disappointed that the Ways and Means Committee, which has fostered and dealt understandingly with the savings and loan business for so many years, is not closing the tax loophole which has permitted privately owned permanent stock savings and loan associations organized in the last 10 years in Maryland, California, and Illinois to convert from mutual institutions to stock companies. In my State of Illinois, we now have some 30 insured State mutual chartered institutions converting to private stock companies, as provided in the Illinois statute, which is inequitable and almost fraudulent as far as the savings account holders are concerned. We are hopeful that the Federal Home Loan Bank Board will exercise its statutory powers and protect the public from the scheming insiders who have received savings accounts due to their being insured by an agency of the Federal Government and now are trying to buy the control and earnings for a mere fraction of what it is worth.

The old stock companies which have not been involved, most of which existed in Ohio and California for many years, should be allowed to continue in a status similar to mutual savings and loans. When the Congress was dealing with the taxation question in 1915, these companies totaled less than 3 percent of the savings and loan assets. There are also 100 stock institutions scattered in other States: 1 in Oregon, a few in Colorado, some in Texas, 2 or 3 in Indiana, although the Indiana law has prohibited organizing of rural permanent stock companies since the midthirties, 1 in Arkansas, a couple in Oklahoma, a few in South Carolina, a few in Idaho, and there may be others, but I don't believe the total is more than 100, outside of Ohio and California, and none was organized with the acquisitive motivation of paying in the capital stock like a bank and controlling and receiving the earnings of the institution beyond such as is paid to the savings accounts or the residual assets in case of liquidation. It is clear that

the trade organizations, State or National, have not given the Ways and Means Committee the full picture of this matter because they don't want to offend a few league members.

I am attaching amendments for your consideration which will accomplish fair taxation for all mutual savings and loans and taxation on a commercial bank basis for privately owned stock companies. I realize that you have many problems and pressures but it seems to me that the committee and the Treasury Department should take time to explore this indefensible tax loophole and policy, which has spawned the California holding companies, conversions of mutuals to stock associations, and most of all—the scandalous Maryland situation. I think the amendment with the grandfather clause protecting institutions which had issued permanent stock prior to 1951 will raise an additional $7 million. If they are put on an equal basis with commercial banks, which they greatly resemble, an additional $20 million in taxes would be raised from the big holding companies that are in the boom areas. This is particularly so in California, where about 80 percent of them are located and their high interest rates make it easy for them to pay regular commercial bank taxes. We should have faced the issue involving them in 1956 in the holding company legislation and had complete divestiture of holding companies when we only had one such company when the matter was placed by some of the savings and loan leaders before the Congress.

It seems to me that the committee, in its work in redrafting its definition of a domestic building and loan association, might take time to study the history and development of the current tax status of savings and loans associations, and the legal decisions, particularly the *Cambridge* case, and the many decisions that preceded it, which can be found in my history of building and loans, chapter XIV, "History of Building and Loan in the United States." A review of this history can lead only to the conclusion that the Congress should close the loophole and deal with mutuals and privately owned stock companies on a separate basis. As you know, the statute dealing with mutual savings banks and cooperative banks requires that they must be mutual and without private capital stock.

Pardon me for writing at length, but there are hundreds, even thousands, in the savings and loan business who have retained the mutual ideas. My good friend, Chairman Spence, of the Banking and Currency Committee, once taught me that the character of a corporation is determined by its principles and ideals, and not by size. We have enough size to help a bit with the income needs of the Federal Government, but among those of substantial size there should be differentiations between those that are operated for private profit of a few insiders and those that are operated in the public interest, and who distribute all of their earnings after expenses, savings dividends and interest, and reserves for bad debts to their savings customers. In this connection, I might say that all of our customers in this institution pay their taxes on their earnings because we have repeatedly brought it to their attention by mailing the attached notices along with every notice of a dividend, and I personally cooperated with the members of the Ways and Means Committee.

I know that many members of the Ways and Means Committee will feel that they have had to give much of their time to the other matters included in the omnibus bill before us. In my legislative experience, we have always been treated very fairly by the Senate Finance Committee; however, I do not hesitate to say that our matters have not received the time in hearings or study there that we have received in the Ways and Means Committee of the House of Representatives. The Ways and Means Committee, being closer to our local mutuals, have been regarded "keepers of our liberties" and our policies in this financial phase.

I hope that the members of the committee will find time to have one more session on the question of the mutual savings and loan associations which includes all of the federally chartered savings and loans and 95 percent by number of the State chartered associations. The present formula, as far as I am informed, does not deal with the tax loophole which will cause controversy and financial scandal in the years ahead, just as we now have in Maryland, and the formula does not fairly and equitably distribute the tax burden among all of the mutual savings and loan associations.

These are my own views and amendments. I have had the collaboration and encouragement of some savings and loan executives of mutual associations who have been active in taxation matters for many, many years. I do not speak for

either of the trade organizations although I belong to both. As you know, there are thousands of mutual savings and loan and cooperative bank directors and executives who have trusted and followed me in these matters in the past. Accordingly, I am also submitting these views and amendments to them. As head of their substantial institutions, they will doubtless study them carefully and, I am sure, express themselves.

Sincerely,

MORTON BODFISH.

AMENDMENTS TO SECTION 8 OF THE PROPOSED REVENUE ACT OF 1962 RELATING TO MUTUAL SAVINGS BANKS, AND SO FORTH

RESERVES FOR LOSSES ON LOANS

(*a*) Subsection 593(a) of section 593 of the Internal Revenue Code of 1954 as amended by section 8(a) of the draft bill would be amended to read as follows:

"(a) *Organizations to which section applies.*—This section shall apply to any mutual savings bank not having capital stock represented by shares, (domestic building and loan association,) *mutual savings and loan association*, or cooperative bank without capital stock organized and operated for mutual purposes and without profit."

(*b*) Subsection (b) of section 593 of the Internal Revenue Code of 1954 as amended by section 8(a) of the draft bill would be amended by striking out paragraphs (1), (2), and (3) and inserting in lieu thereof the following:

"(1) *In general.*—For purposes of section 166(c), the reasonable addition for the taxable year to the reserve for bad debts of any taxpayer described in subsection (a) shall be the amount determined by the taxpayer, but shall not exceed the amount determined under paragraph (2) or (3), whichever such amount is the larger.

"(2) *Seventy-five percent of taxable income.*—The amount determined under this paragraph for the taxable year shall be an amount equal to 75 percent of the taxable income for such year. For purposes of this paragraph, taxable income shall be computed without regard to any deduction allowable for any addition to the reserve for bad debts.";

and by renumbering paragraphs (4) and (5) as (3) and (4), respectively.

2. DEFINITION OF THE TERM "MUTUAL SAVINGS AND LOAN ASSOCIATION"

Section 8 of the draft bill would be amended by incorporating therein the following new subsection:

"( ) Section 7701(a) of the Internal Revenue Code (relating to definitions) is amended by amending paragraph (19) (relating to definition of domestic building and loan association) to read as follows:

" 'Domestic building and loan association, mutual savings and loan association, stock savings and loan association.—The term "domestic building and loan association" means a domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association, substantially all the business of which is confined to making loans to members; the term "mutual savings and loan association" means a domestic building and loan association the principal business activities of which are to receive the savings of individuals for deposit and to make loans for which improved residential real estate is the sole security, which business activities are carried on pursuant to a charter or articles of incorporation or association issued or entered into under or pursuant to the laws of the United States or of a State or territory, or of the District of Columbia, and are subject to periodic examination by a supervisory authority designated in the law pursuant to which the charter or articles of incorporation or association is issued or entered into, and which, if it has outstanding capital stock represented by nonwithdrawal shares, (i) none of such capital stock was issued after December 31, 1951, and (ii) not more than 10 percent of such capital stock is held directly or indirectly by any company, as defined by section 408(a) of the National Housing Act, as amended; and the term "stock savings and loan association" means a domestic building and loan association, which would be a mutual savings and loan association, if it did not have outstanding capital stock represented by nonwithdrawal shares which either (i) were issued after December 31, 1951, or (ii) more than 10 percent of which is

held directly or indirectly by any company, as defined by section 408(a) of the National Housing Act, as amended.' "

3. DEDUCTION FOR DIVIDENDS PAID ON DEPOSITS

Section 8 of the draft bill would be amended by incorporating therein the following new subsection:

"( ) Section 591 of the Internal Revenue Code (relating to deduction for dividends paid on deposits) is amended by striking out the words 'and domestic building and loan associations' and by inserting in lieu thereof the words 'mutual savings and loan associations, and stock savings and loan associations.' "

4. DEFINITION OF "BANK"

Section 8 of the draft bill would be amended by incorporating therein the following new subsection:

"( ) Section 581 (relating to definition of 'bank') is amended by striking out the last sentence and by inserting in lieu thereof the following new sentence: 'Such term also mean a mutual savings and loan association and a stock savings and loan association.' "

5. ADDITIONS TO RESERVES FOR BAD DEBTS OF STOCK SAVINGS AND LOAN ASSOCIATIONS

Section 8 of the draft bill would be amended by incorporating therein the following new subsection:

"( ) Part II of subchapter H of chapter 1 (relating to mutual savings banks, etc.) is amended by inserting immediately after section 593 thereof the following new section:

" 'Sec. 594. Additions to reserves for bad debts of stock savings and loan associations.

" '(a) Establishment of reserves.—In the case of a stock savings and loan association, the reasonable addition to a reserve for bad debts under section 166 (c) shall be determined with due regard to the amount of the taxpayer's surplus or bad-debt reserves existing at the close of December 31, 1962, and shall be determined in accord with the principles which the Secretary or his delegate shall have prescribed for determination of the reserve for bad debts of commercial banks pursuant to section 166(c).

" '(b) Allocation of pre-1963 reserves.—If the amount of the reserve for bad debts of a stock savings and loan association determined as of the close of December 31, 1962, shall be greater than the amount determined under subsection (a), the amount of such excess shall be allocated to the supplemental reserve for losses on loans, and shall not be included in the gross income of the stock savings and loan association.' "

6. FORECLOSURE ON PROPERTY-SECURING LOANS

Section 595(a) of the Internal Revenue Code of 1954 as added by section 8(b) of the draft bill would be amended by striking out the words "Section 593(a)" and by inserting in lieu thereof the word "Section 593(a) or Section 594(a)."

7. CHANGE IN SECTION NUMBER

Section 8 of the draft bill would be amended by incorporating therein the following new subsection:

"( ) Section 594 (relating to alternative tax for mutual savings banks conducting life insurance business) is hereby renumbered 'Section 596'."

EXPLANATION OF AMENDMENTS TO SECTION 8 OF THE PROPOSED REVENUE ACT OF 1962 RELATING TO MUTUAL SAVINGS BANKS, ETC.

Section 1 relating to reserves for losses on loans, would modify the proposed reserve for bad debts for mutual savings banks, domestic building and loan associations, and mutual cooperative banks by deleting the alternative based upon a percentage of loans outstanding and would provide merely two alternatives; namely, the higher of 75 percent of taxable income computed without regard to the reserve for bad debts, or an amount based upon actual experience of the taxpayer in having loans become worthless. As so modified, section 1 would

be limited solely to mutual savings and loan associations and would not be available to stock savings and loan associations.

Section 2, relating to definition of the term "mutual savings and loan associations," would add to the Internal Revenue Code definitions of the terms "mutual savings and loan association" and "stock savings and loan association." Under the definitions, a mutual savings and loan association would include a domestic building and loan association engaged primarily in receiving the savings of individuals for deposit and making loans on residential real estate which are subject to regular and periodic examination by State or Federal agencies. If such an association has outstanding capital stock represented by nonwithdrawable shares, the stock must not have been issued after December 31, 1951, and even if issued before December 31, 1951, not more than 10 percent may be held by a holding company. A stock savings and loan association would differ from a mutual savings and loan association only from the standpoint of outstanding capital stock issued after December 31, 1951 or ownership by a holding company of stock issued before December 31, 1951.

Section 3, relating to deduction for dividends paid on deposits, would provide for amendment of section 591 of the Internal Revenue Code to make clear that the deduction for dividends paid on deposits would be available to both mutual savings and loan associations and stock savings and loan associations.

Section 4, relating to definition of "bank," makes a technical correction in the definition of the term "bank," provided by section 581, so that the term would include both a mutual savings and loan association and a stock savings and loan association for the limited purposes of that definition.

Section 5, relating to addition to reserves for bad debts of stock savings and loan associations, would limit stock savings and loan associations to the same reserve for bad debts as commercial banks for taxable years after 1962, but would preserve for such associations the benefit of the reserves which they have accumulated under existing law.

Section 6, relating to foreclosure on property-securing loans, would make a technical amendment to insure that the proposed tax treatment with respect to property acquired on foreclosure of a loan is available both to the stock savings and loan associations as well as to mutual savings and loan associations.

Section 7, relating to change in section number, would merely change the number of a present provision of the code relating to an alternative tax for mutual savings banks conducting a life insurance business. There is no change in substance.

NATIONAL ASSOCIATION OF REAL ESTATE BROKERS, INC.,
Chicago, Ill., April 3, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR CHAIRMAN BYRD: The National Association of Real Estate Brokers, Inc., is an organization of 750 Negro real estate brokers, with members in 40 States, including each of the largest and most populous States. Much of the work of our members is devoted to assisting Negro families to buy homes; we are, therefore, deeply interested in any legislation which affects the supply of mortgage credit, and particularly that portion of the supply of mortgage credit available to Negro families and other minority groups.

For this reason, we are obliged to state our views on H.R. 10650, the tax revision bill passed by the House of Representatives, which includes a drastic increase in the amount of income taxes levied against thrift institutions, that is, savings and loan associations and mutual savings banks.

Our interest in the taxes imposed on these institutions stems from the fact that the achievement of homeownership among Negroes and other minority groups is overwhelmingly dependent upon home mortgage loans granted by these financial organizations. In 1961, for example, 50 percent of all homes purchased by American families were financed by savings and loan associations and mutual savings banks. However, of the homes purchased by Negro and other minority families, we estimate that approximately 70 percent were financed by savings and loan associations and mutual savings banks.

Thus, the typical nonwhite home-buying family is more dependent upon mortgage credit supplied by the thrift institutions than is the typical white family. To the extent, therefore, that heavier income taxes impair the abiliy of thrift

institutions to finance home buying, the injury to the minority family is proportionately greater than the injury to the white family.

In the Housing Act of 1949, the Congress set a national objective of "a good home in a suitable living environment for every American family." Since that time, tens of thousands of minority families have moved into decent homes of their own with loans secured from savings and loan associations and savings banks. Without this financing, the great majority of these families would have been forced to remain in areas which have the worst schools, the least amount of recreational facilities, the poorest police protection and inferior municipal services. Without this financing, the growth of a middle class among minority groups, characterized by a desire to own good homes and an ability to pay the cost of good homes, would have been largely frustrated.

We earnestly hope that the slow but steady increase in Negro homeownership will not be interrupted by an income tax increase on savings and loan associations and savings banks of the magnitude recommended in H.R. 10650. We recommend, therefore, (1) that no change be made in the present tax law governing these institutions, or (2) in the alternative, that the tax formula proposed in H.R. 10650 be changed in order to assure a less onerous tax increase on these institutions.

Sincerely,

BOLIN V. BLAND,
Chairman, Committee on Mortgage Financing.

NINTH FEDERAL SAVINGS AND LOAN ASSOCIATION OF NEW YORK CITY,
New York, N.Y., March 29, 1962.

Hon. HARRY F. BYRD,
Senate Office Building, Washington, D.C.

MY DEAR MR. BYRD: I don't want to belabor the matter of the taxation of mutuals but my organization has gone through a great many computations and now finds that the bill in its present form contains a loophole you could drive a truck through. Specifically, it permits all savings banks and State-chartered savings and loans comprising about half our business to very materially reduce their tax liability by converting a small portion of their investments into tax exempts.

The end result of these conversions will be that Federal savings and loan associations will bear an inequitably high portion of the total taxes ultimately paid by mutuals.

The loophole referred to arises from the formula proposed for the allocation of pre-1963 reserves. This permits mutuals to allocate from their existing reserves to the qualifying reserve only 3 percent of outstanding mortgages. Thereafter annual allocations to the qualifying reserve to the extent of 3 percent of annual mortgage portfolio growth would be permitted.

Our calculations show that by the simple expedient of converting to or investing in a small proportion of tax exempts a State-chartered savings and loan or savings bank can reduce or eliminate its tax liability by the use of the foregoing option. The motivation to use this loophole is evident since by such manipulation State-chartered institutions would also increase their retained income. This is not possible under the 60/40 option, in fact the reverse is true.

The attached chart[1] and illustration are a simple, albeit correct, indication of how this can be accomplished. The upshot is that the Treasury's $160 to $200 million in taxes will shrink to $80 to $100 million or less as indicated below.

[In millions]

	Anticipated	Our estimate
Savings banks	$60–80	$15–20
State savings and loans	45–55	10–15
Federal savings and loans	55–65	55–65
Total	160–200	80–100

[1] Because the chart attached was in color it could not effectively be reproduced; thus it was made a part of the committee files.

How best to plug this gap? By eliminating the privilege of treating its pre-1963 reserves as mentioned heretofore this loophole can be eliminated.

If the foregoing makes sense to your committee, then, on the premise that the Treasury is already cognizant of this situation, I respectfully submit that consideration be given to upgrading the 60 percent option so that all mutual savings institutions will be treated alike.

Thank you for your consideration and attention to this matter.

Sincerely yours,

JULIAN R. FLEISHMANN.

P.S. The travesty of this situation is that the bill contains a tax haven for the giant savings and loan stock companies in California, etc., that is not available to federally chartered mutuals.

Per $100,000,000 of investments: (a) Net income at 1 percent; (b) annual growth at 20 percent; (c) 1-percent income loss from converting

	Percent converted to tax exempts at 3½ percent interest			
	0 percent	3 percent	6 percent	9 percent
1. Net income (a)	$1,000,000	$970,000	$940,000	$910,000
2. Less tax exempt income		105,000	210,000	315,000
3.	1,000,000	865,000	730,000	595,000
OPTION (A)				
4. 60 percent to reserve	600,000	519,000	438,000	357,000
5. Taxable income	400,000	346,000	292,000	238,000
6. Taxes estimated at 50 percent	200,000	173,000	146,000	119,000
7. Retained (lines 1-6)	800,000	797,000	794,000	791,000
OPTION (B)				
8. 3 percent of $20,000,000 (b)	600,000	600,000	600,000	600,000
9. Taxable income	400,000	265,000	130,000	
10. Taxes estimated at 50 percent	200,000	132,500	65,000	
11. Retained (lines 1-10)	800,000	837,500	875,000	910,000
OPTION (C)—12 PERCENT GROWTH				
12. 3 percent of $12,000,000	360,000	360,000	360,000	360,000
13. Taxable income	640,000	505,000	370,000	235,000
14. Taxes estimated at 50 percent	320,000	252,500	185,000	117,500
15. Retained (lines 1-14)	680,000	717,500	755,000	792,500

TRADERS NATIONAL BANK,
Kansas City, Mo., April 3, 1960.

Hon. STUART SYMINGTON,
U.S. Senator, Senate Office Building,
Washington, D.C.

DEAR SENATOR: House bill 10650 has just gone to the Senate and is in the Finance Committee and I am sure it will be on the floor of the Senate very shortly.

Senator, I talked to you a couple of times about the proposal for banks to withhold interest on time deposits. We are already a collecting agency for the Government for free on so many things that are burdensome, but to withhold on savings interest would be a tremendous task and certainly a burden that the Government should not saddle on us. Not only for the expense, but for the ill will we are going to build up with our customers, no matter what explanation is made. Personally, I cannot see the need, certainly not right now when the Government is installing data-processing automation machines which will tell them who did not report and how much. The mere fact it is common knowledge to the taxpayer that the Government has such information certainly will force the taxpayer to make full returns. I hope you see it our way.

Also, Senator, I feel that the bill, as it comes to you on taxes of savings and loans and mutual savings, has been watered down much too thin and I hope the Senate restores at least part of the cut the House committee made from

the original draft of the bill. I am sure your considered judgment in all these matters will in the end result in the proper conclusion.

With kindest personal regards, I am,

Yours very truly,

R. L. DOMINICK,
Chairman of the Board.

STATEMENT OF PENNSYLVANIA BANKERS ASSOCIATION ON TAX UNIFORMITY

The Pennsylvania Bankers Association Council of Administration reaffirms its position that the present condition of Federal tax inequity between commercial banks, savings and loan associations and other mutual organizations should be corrected without further delay. The association is convinced that the present draft of H.R. 10650, as passed by the House of Representatives on March 29, does not represent a proper correction of this tax inequality upon financial institutions. The present provision which would accord savings and loan associations a tax free gift of 60 percent of net earnings is intolerable and is not in keeping with the American heritage of fair play. We agree with the position of U.S. Secretary of the Treasury Douglas Dillon in his testimony before the Senate Finance Committee on April 2 on H.R. 10650, with regard to the taxation of savings and loan associations. We urge the U.S. Senate to amend the 60 percent of net earnings provision of H.R. 10650, in the manner suggested by Secretary Dillon.

I, Belden L. Daniels, secretary of the Pennsylvania Bankers Association, certify the foregoing to be a true copy of the Statement on Tax Uniformity unanimously adopted by the Pennsylvania Bankers Association Council of Administration at Skytop, Pa., on April 9, 1962. The association's position of strong opposition to the proposed Federal withholding tax on interest and dividends, which is also included in H.R. 10650, will be presented by association representative G. Edward Cooper, at the U.S. Senate Finance Committee hearing in Washington on April 18, 1962.

BELDEN L. DANIELS, *Secretary.*

CHICAGO, ILL.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: As you know, through the years I have spent a great deal of study and time on legislation helping create, improve, and protect the modern mutual savings and loan program. Of all my experiences in Washington, I treasure most the confidence the Banking and Currency Committee had in me in the years I was working on credit union and savings and loan legislation. I helped write the original Federal Home Loan Bank Act, was a member on the original Federal Home Loan Bank Board, helped do the Home Owners' Loan Corporation Act which included the legislation for Federal mutual savings and loan charters, participated in drafting the Federal Savings and Loan Insurance Corporation legislation (the FDIC for savings and loans) of account legislation, did the section in the Servicemen's Readjustment Act of 1946 for Senator McFarland and Representative Cunningham (incidentally, the ABA opposed savings and loans participating in this program), and have worked on savings and loan tax matters since 1926. In fact, I took a very active role in 1951, when Congress last amended the revenue statute dealing with domestic building and loan associations.

I now am chairman of the board and president, First Federal Savings & Loan Association of Chicago. As chairman of the Council of Presidents of Mutual Savings Institutions, I submit the attached draft of amendments to section 8 of H.R. 10650, the pending Revenue Act of 1962, to accomplish two major purposes:

1. To insure that the provisions for bad debt reserves of mutual savings institutions are limited to organizations that are genuinely mutual in the historic sense, and are denied to stock savings and loan associations, which have abused and exploited the reserve for bad debts provided by the Revenue Act of 1951 and subsequent tax laws.

2. To afford to mutual savings institutions a uniform standard for additions to the reserve for bad debts which will not dangerously impair reserves, nor

require reduction of the dividend rate payable to savers below a level required to assure an adequate supply of funds for long-term home financing at reasonable rates of interest.

A. THE DISTINCTION BETWEEN MUTUAL AND STOCK SAVINGS AND LOAN ASSOCIATIONS MUST BE RECOGNIZED

When the exemption from Federal income taxation of domestic building and loan associations was repealed by the Revenue Act of 1951, Congress recognized that the maintenance of the financial security of millions of individual investors required that building and loan associations be permitted some latitude in regard to the size of their reserves for bad debts. Accordingly, such an association is permitted to exercise its own judgment as to the reasonable amount of the addition to its reserves for bad debts. Any amount so added is allowable as a deduction for Federal income tax purposes within certain limitations imposed by section 593.

The general tenor of section 593 strongly indicates that the favorable tax treatment was intended by Congress to benefit the mutual savings and loan associations and their members and to promote homeownership by holding interest rates on home loans to a moderate level. Congress also manifested the intention of preserving the traditional local and mutual characteristics of savings and loan institutions, since those characteristics have provided the basis for the success of and public confidence in these institutions.

A serious loophole in section 593, however, has been vigorously exploited by certain individuals and has resulted in many flagrant abuses of legislative equity. The loophole is found in the fact that the benefits heretofore conferred by section 593 in regard to bad debt reserves are not limited to truly mutual savings and loan associations, but may also be enjoyed by associations which issue nonwithdrawable shares and which do not differ in form or function from ordinary profit-seeking corporations.

The permanent shareholders of these stock associations usually have a small investment in the association and yet are in a position to siphon off to themselves, as dividends, the tax-free reserves built up as a protection to savers against future losses from home loans made by the association. The permanent stockholders of these stock associations often transfer their stock to a holding company which, in turn, issues new stock for public sale. The profits subsequently earned are taxable to the permanent stockholders at capital gain rates, and are based almost entirely upon the capitalized value of the allowance for bad debt reserves of the association. Thus the benefits intended for mutual association members are being reaped by outside investment interests.

The activities of these stock companies have produced some highly unsavory scandals, the most infamous of which have occurred in Maryland and Arizona. Nor are these abusive practices likely to decline in the near future, for in Illinois alone 20 savings and loan institutions are presently in the process of converting to stock associations.

The mass infiltration of holding companies into the savings and loan area is also a result of the loophole referred to above and is in direct contravention of expressed congressional intent. The mutual and local characteristics of savings and loan institutions are destroyed by the absentee ownership of farflung holding company domains.

To close this loophole and to remedy the abuses which have resulted therefrom, section 593 must be amended so as to exclude from its purview those associations which obtain capital through the issuance of nonwithdrawable shares. It is significant that section 593 in its present form excludes savings banks and cooperative banks with capital stock outstanding, and the suggested amendments would merely apply the same rules with respect to savings and loan associations. A "grandfather" clause would recognize the validity of nonwithdrawable shares issued by a savings and loan association on or before December 31, 1951, the effective date of the bad debt reserves provided by Congress for mutual thrift institutions, unless such stock is held by a holding company.

B. THE STANDARD FOR RESERVES FOR BAD DEBTS OF MUTUAL SAVINGS INSTITUTIONS SHOULD BE ADEQUATE FOR LONG-RANGE FINANCIAL SOUNDNESS AND SUFFICIENT TO ATTRACT SAVINGS

Aside from the urgency of eliminating the opportunity for abuse of the provision for bad debt reserves for mutual savings institutions, which should surely be a matter of as great concern to Congress as to the genuinely mutual members

of the savings and loan industry, it is also critical that recognition be given to the impact of the recommendations of the Treasury Department and the effect of the restrictive reserve provisions under section 8 of H.R. 10650, as passed by the House of Representatives.

Some of the consequences of the Treasury recommendations and their devastating impact on reserves or on dividend rates of mutual savings institutions are described in the report of the Federal Home Loan Bank Board to the Committee on Ways and Means dated August 4, 1961. This report appears at pages 25-37 of the hearings before the Committee on Ways and Means on the Treasury Department report on "Taxation of Mutual Savings Banks and Loan Associations."

Considering the impact on reserves, this report states, "The Federal Home Loan Bank Board cannot permit the impact of the Treasury staff tax proposal to fall on reserves." After demonstrating statistically what the effect of the Treasury proposals would have been, if in effect during the period 1954-60, the Federal Home Loan Bank Board concludes that the erosion of reserves thereby resulting "could not have been tolerated by responsible supervisors of a financial system, almost all the assets of which are long-term mortgages."

If reserves are not to be permitted to decline, the impact must be absorbed by reduction in the dividend rate payable to savers. According to the Federal Home Bank Board, this would have required that the average dividend rate of 4 percent in effect from 1954 to 1960 be reduced to 3.36 percent, a decline of sixty-four one-hundredths of 1 percent.

We are presently analyzing a survey among mutual savings institutions as to the effect of the reserve formulas provided by section 8 of H.R. 10650, as passed by the House. Although this study is not yet complete, it is already apparent that the 60-40 formula under the House bill will adversely affect the soundness of many mutual thrift institutions. Indeed, I think it is safe to say that some of those which would most certainly fall within the area of the historic, protective concern of the Congress because of their contribution to private home-ownership in the smaller, more stable communities would be the most seriously injured. Moreover, the differentiation measured by 3 percent of the increase in real property loans provided for rapidly expanding institutions is a strange competitive inequity to inject into a tax system.

The attached amendments would minimize the risk of impairment of loss reserves and forces reduction of dividends paid to savers, or both, by substituting a 75-25 formula for the 60-40 formula in the House bill and would delete the alternative based upon 3 percent of real property loans.

As indicated, the study now in process will surely provide further substantiation of the views herein expressed. If it should be completed in time to be included in the record of these hearings, permission is respectfully requested that a memorandum summarizing the relevant facts and conclusions, and including further supporting material regarding the basic differences between stock and mutual savings and loan associations may be submitted.[1]

Yours truly,

MORTON BODFISH.

SUGGESTED AMENDMENTS TO SECTION 8 OF H.R. 10650 IN THE SENATE, RELATING TO THE RESERVE FOR BAD DEBTS OF MUTUAL SAVINGS INSTITUTIONS

It is urged that section 8 of H.R. 10650 in the Senate be amended as follows:

On page 44, in lines 12 and 13, strike out the words "domestic building and loan association" and insert in lieu thereof the words "mutual savings and loan association".

On page 44, strike out beginning with line 16 down to and including line 23 on page 45, and insert in lieu thereof the following:

"(b) ADDITIONS TO RESERVES FOR BAD DEBTS.—

"(1) IN GENERAL.—For purposes of section 166(c), the reasonable addition for the taxable year to the reserve for bad debts of any taxpayer described in subsection (a) shall be the amount determined by the taxpayer, but shall not exceed the amount determined under paragraph (2) or (3), whichever such amount is the larger.

"(2) 75 PERCENT OF TAXABLE INCOME.—The amount determined under this paragraph for the taxable year shall be an amount equal to 75 percent of

[1] The memorandum referred to will be incorporated in the last volume of the hearings if received before printing date.

the taxable income for such year. For purposes of this paragraph, taxable income shall be computed without regard to any deduction allowable for any addition to the reserve for bad debts."

On page 45, line 24, strike out "(4)" and insert in lieu thereof "(3)".

On page 46, strike out beginning with line 5, down to and including line 2, on page 53, and insert in lieu thereof the following:

"(d) Part II of subchapter H of chapter I (relating to mutual savings banks, and so forth) is amended by inserting immediately after section 593 thereof the following new section:

"SEC. 594. RESERVES FOR BAD DEBTS OF STOCK SAVINGS AND LOAN ASSOCIATIONS.—

"(a) ESTABLISHMENT OF RESERVES.—In the case of a stock savings and loan association, the reasonable addition to a reserve for bad debts under section 166(c) shall be determined with due regard to the amount of the taxpayer's surplus or bad debt reserves existing at the close of December 31, 1962, and shall be determined in accord with the principles which the Secretary or his delegate shall have prescribed for determination of the reserve for bad debts of commercial banks pursuant to section 166(c).

"(b) ALLOCATION OF PRE-1963 RESERVES.—If the amount of the reserve for bad debts of a stock savings and loan association determined as of the cost of December 31, 1962, shall be greater than the amount determined under subsection (a), the amount of such excess shall be allocated to the supplemental reserve for losses on loans.

"(c) DISTRIBUTIONS TO SHAREHOLDERS.—

"(1) IN GENERAL.—For purposes of this chapter, any distribution of property (as defined in section 317 (a)) by a stock savings and loan association to a shareholder with respect to its stock, if such distribution is not allowable as a deduction under section 591, shall be treated as made—

"(A) first out of the supplemental reserve for losses on loans, to the extent thereof;

"(B) then out of its earnings and profits accumulated in taxable years beginning after December 31, 1951, to the extent thereof; and

"(C) then out of such other accounts as may be proper.

"(2) AMOUNTS CHARGED TO RESERVE ACCOUNTS AND INCLUDED IN GROSS INCOME.—If any distribution is treated under paragraph (1) as having been made out of the reserve described in subparagraph (A) of such paragraph, the amount charged against such reserve shall be the amount which, when reduced by the amount of tax imposed under this chapter and attributable to the inclusion of such amount in gross income, is equal to the amount of such distribution; and the amount so charged against such reserve shall be included in gross income of the taxpayer. For purposes of this subsection, the term 'distribution' includes any distribution in redemption of stock or in partial or complete liquidation of the association."

On page 53, line 3, strike out "(b)" and insert in lieu thereof "(c)".

On page 53, line 10, strike out "section 593(a)" and insert in lieu thereof "section 593(a) or section 594(a)".

On page 54, strike out beginning with line 11 down to and including line 8 on page 55, and insert in lieu thereof the following:

"(d) DEFINITION OF DOMESTIC BUILDING AND LOAN ASSOCIATION, MUTUAL SAVINGS AND LOAN ASSOCIATION, AND STOCK SAVINGS AND LOAN ASSOCIATION.—Paragraph (19) of section 7701(a) (definition of domestic building and loan association) is amended to read as follows:

"DOMESTIC BUILDING AND LOAN ASSOCIATION, MUTUAL SAVINGS AND LOAN ASSOCIATION, STOCK SAVINGS AND LOAN ASSOCIATION.—The term 'domestic building and loan association' means a domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association, substantially all the business of which is confined to making loans to members; the term 'mutual savings and loan association' means a domestic building and loan association the principal business activities of which are to receive the savings of individuals for deposit and to make loans for which improved residential real estate is the sole security, which business activities are carried on pursuant to a charter or articles of incorporation or association issued or entered into under or pursuant to the laws of the United States or of a State or Territory, or of the District of Columbia, and are subject to periodic examination by a supervisory authority designated in the law pursuant to which the charter or articles of incorporation

or association is issued or entered into, and which, if it has outstanding capital stock represented by nonwithdrawable shares, (i) none of such capital stock was issued after December 31, 1951, and (ii) not more than 10 percent of such capital stock is held directly or indirectly by any company, as defined by section 408(a) of the National Housing Act, as amended; and the term 'stock savings and loan association' means a domestic building and loan association which would be a mutual savings and loan association, if it did not have outstanding capital stock represented by nonwithdrawable shares which either (i) were issued after December 31, 1951, or (ii) more than 10 percent of which is held directly or indirectly by any company, as defined by section 408(a) of the National Housing Act, as amended.

"(e) Section 591 of the Internal Revenue Code (relating to deduction for dividends paid on deposits) is amended by striking out the words 'and domestic building and loan associations' and by inserting in lieu thereof the words 'mutual savings and loan associations, and stock savings and loan associations.'

"(f) Section 581 (relating to definition of bank) is amended by striking out the last sentence and by inserting in lieu thereof the following new sentence: 'Such term also means a mutual savings and loan association and a stock savings and loan association.' "

On page 55, strike out beginning with line 9 down to and including line 14, and insert in lieu thereof the following:

"(g) CLERICAL AMENDMENTS.—

"(1) The table of sections for part II of subchapter H of chapter 1 is amended—

"(i) by striking out the third item and inserting in lieu thereof the following:

"Sec. 593. Reserves for losses on loans of mutual savings institutions
"Sec. 594. Reserves for bad debts of stock savings and loan associations.

"(ii) by adding at the end thereof the following:

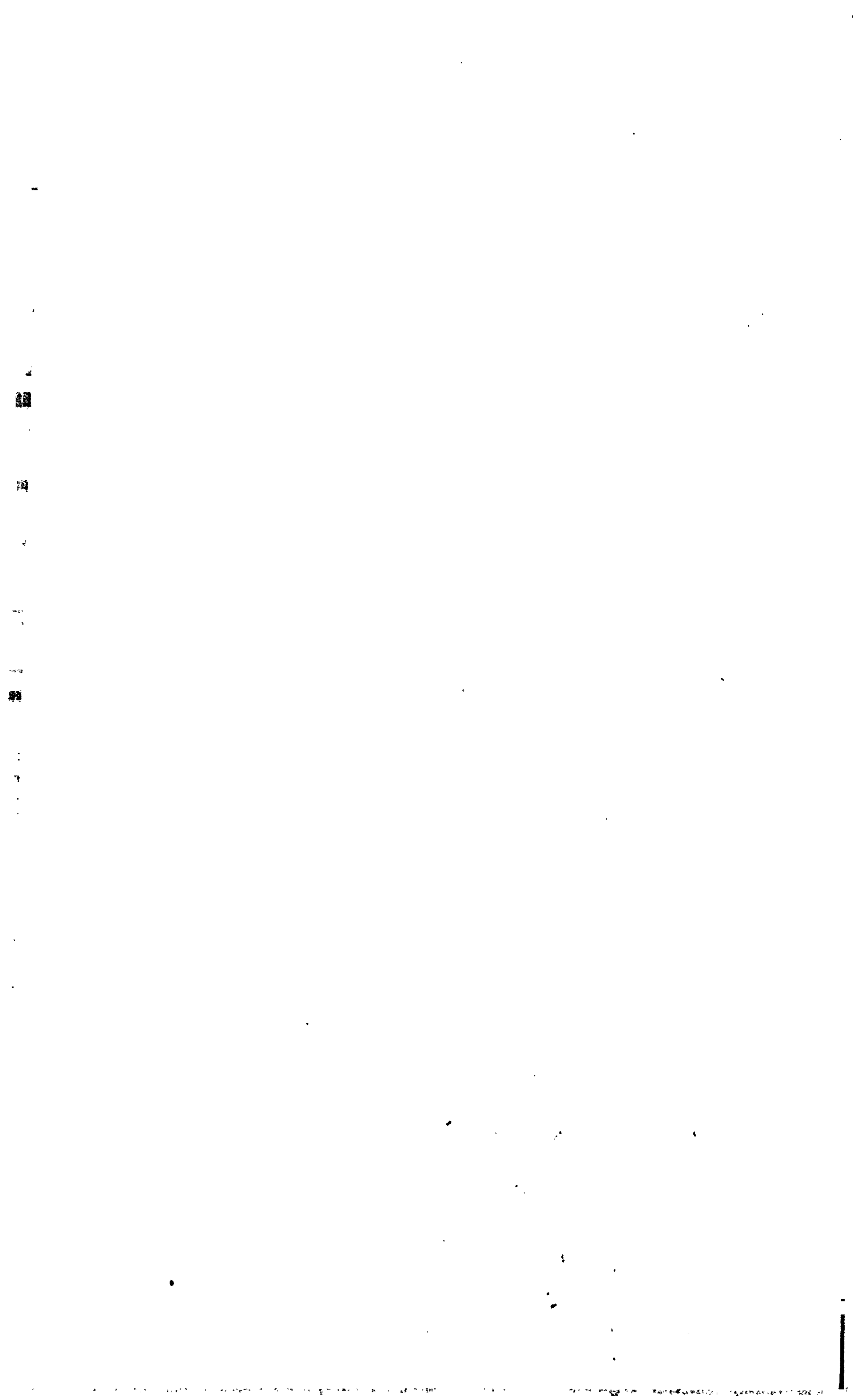
"Sec. 595. Foreclosure on property securing loans.
"Sec. 596. Alternative tax for mutual savings banks conducting life insurance business.

"(2) Section 594 (relating to alternative tax for mutual savings banks conducting life insurance business) is hereby renumbered 'Section 596'."

On page 55, line 15, strike out "(e)" and insert in lieu thereof "(h)", and in line 23, strike out "(f)" and insert in lieu thereof "(i)".

On page 55, line 24, strike out "subsection (a)" and insert in lieu thereof "subsection (a), (b), (d), (e) and (f)".

(Whereupon, at 6 p.m., the hearing recessed until 10 a.m., Thursday, April 12, 1962.)



REVENUE ACT OF 1962

THURSDAY, APRIL 12, 1962

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (the chairman) presiding.

Present: Senators Byrd, Long, Smathers, Douglas, Gore, Hartke, Williams, Carlson, Bennett, Butler, and Curtis.

Also present: Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. M. Woodworth, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

The Chair submits for the record a letter from the Honorable Norris Cotton, advocating enactment of his amendment 4-10-62—B.

(The letter, with attached explanation and copy of the amendment follows:)

U.S. SENATE,
COMMITTEE ON COMMERCE,
April 11, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: As you know, I introduced an amendment to H.R. 10650, which changes the effective date of Public Law 86-376. This law amended subchapter S of the 1954 code to cover situations where a shareholder of a small business corporation, electing to deduct his pro rata share of the corporation's net losses, dies before the end of the corporation's taxable year. The amendment would make the change in the law retroactive to September 2, 1958, the date subchapter S was enacted.

My interest in this matter is occasioned by the death of former New Hampshire Gov. Francis Murphy. I believe that his estate is entitled to the same tax treatment as the estates of persons dying after the effective date of the 1959 act.

It is my hope that this proposal can be considered by the committee during its hearings on H.R. 10650, which makes other technical changes in the tax laws. I am enclosin ga copy of the amendment and a brief explanatory statement.

Both the Treasury Department and Bureau of the Budget submitted their views on a similar proposal, S. 2789, which Senator Bridges and I introduced in the 86th Congress. I believe the equity of my amendment, which would affect a very limited number of similar cases, is sufficient to merit the careful attention of the committee, despite the general views of these agencies about retroactive application of changes.

With every good wish,

Yours sincerely,

NORRIS COTTON, *U.S. Senator.*

[H.R. 10650, 87th Cong., 2d sess.]

AMENDMENT

Intended to be proposed by Mr. Cotton to the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes, viz: At the end of the bill add the following new section:

SEC. 22. AMENDMENT TO EFFECTIVE DATE OF SECTION 2(b) OF PUBLIC LAW 86-376

The second sentence of subsection (d) of section 2 of Public Law 86-376 (73 Stat. 699) is amended to read as follows: "The amendment made by subsection (b) shall take effect on September 2, 1958, and the amendment made by subsection (c) shall take effect on September 24, 1959."

BRIEF EXPLANATION OF AMENDMENT TO H.R. 10650 INTRODUCED BY MR. COTTON ON APRIL 10, 1962

In the Technical Amendments Act of 1958 the Congress enacted subchapter S, relating to small business corporations. Under these provisions a qualified small business corporation can elect to have its income taxed directly to its shareholders and to have its net operating losses passed through directly to its shareholders. As initially enacted in 1958, section 1374 allowed a shareholder of an electing small business corporation to deduct his pro rata share of the corporation's net operating loss for his taxable year in which or with which the taxable year of the corporation ends. However, a shareholder who dies before the end of the corporation's taxable year was deprived of his share of the net operating loss which occurred in the corporation's taxable year in which he died because there was no taxable year of the corporation that ended with or within the abbreviated taxable year of the shareholder. Because of this, section 1374 was amended by section 2(b) of Public Law 86-376, 86th Congress, 1st session, to make it clear that in such a case a deceased shareholder will not be denied his pro rata share of the electing small business corporation's net operating loss. This amendment, however, was made effective only from the day after the date of the enactment of Public Law 86-376. This was September 24, 1959.

The purpose of the proposed amendment is to make the effective date of this particular provision of Public Law 86-376 September 2, 1958, the date of the original enactment of subchapter S, in order that shareholders of an electing small business corporation who died prior to September 24, 1959 are also not denied their pro rata share of the net operating loss of the electing small business corporation occurring in the year of the shareholder's death.

The CHAIRMAN. The first witness this morning is Henry A. Bubb, United States Savings & Loan League.

You may proceed, sir.

STATEMENT OF HENRY A. BUBB, LEGISLATIVE COMMITTEE CHAIRMAN, UNITED STATES SAVINGS & LOAN LEAGUE; ACCOMPANIED BY NORMAN STRUNK, EXECUTIVE VICE PRESIDENT; AND WILLIAM McKENNA, TAX CONSULTANT; AND STEPHEN SLIPHER, LEGISLATIVE DIRECTOR

Mr. BUBB. Mr. Chairman, and members of the committee, I am Henry Bubb of Topeka, Kans., and I appear here today as chairman of the legislative committee of the United States Savings & Loan League.[1]

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[1] The United States Savings & Loan League is a nationwide trade organization with over 4,800 member institutions, including federally chartered, State chartered, insured and uninsured associations. Its principal officers are M. L. Dye, president, Salt Lake City; F. B. Yeilding, Jr., vice president, Birmingham, Ala.; Norman Strunk, executive vice president, Chicago; and Stephen Slipher, legislative director, Washington D.C.

I appreciate the opportunity of expressing to the committee our concern over the magnitude of the additional tax proposed for our institutions.

I have with me Mr. Norman Strunk, executive vice president of the United States Savings & Loan League, Stephen Slipher, legislative director here in Washington, and William McKenna, special consultant to the league.

Mr. Chairman, if it is all right with you and to save time, I would appreciate any one of the four of us being able to answer without again identifying ourselves.

The CHAIRMAN. It is agreeable, that is all right.

Mr. BUBB. Today there are 6,200 savings and loan associations in the United States holding the savings of 29 million Americans. These associations are the dominant source of housing credit, last year making 44 percent of all the home loans in the country. This is more than twice the volume of home loans made by all the commercial banks and insurance companies combined.

H.R. 10650 as passed by the House of Representatives makes far-reaching changes in the tax law of savings and loan associations, and entails a serious curtailment in the reserve-accumulating ability of savings and loan associations. No one should underestimate the importance of these reserves.

They are, first of all, a positive force for the public interest since the ability of savings and loan institutions to grow—and thus to serve home buyers—is directly dependent upon their ability to accumulate reserves.

They are, secondly, a preventive force because they stand as the major line of defense against the possible failure of various institutions.

Viewed in this light, reserves are an essential bulwark to the continued health and smooth functioning of financial institutions in thousands of American communities.

The relationship of taxation and reserves is, therefore, not an incidental part of the savings and loan story. It is a crucial question indeed and the verdict of the Congress will be a most decisive factor in determining the future development and direction and usefulness of our business.

THE ROLE OF RESERVES IN THE NATIONAL ECONOMY

Until 1951 savings and loan associations were exempt from Federal income tax. The Revenue Act of 1951 made our associations subject to the corporate income tax after deduction for expenses, payments to savers, and a special allowance for bad debt reserves which permitted allocations to reserves until such reserves equaled 12 percent of savings.

Both the law and the subsequent regulations were very strict that any funds placed in these reserves must be used only to meet bad debt losses. If they are ever used for any other purpose, they must be taken back into the income stream and subjected to tax.

The decade of the 1950's was characterized by a prolonged period of high levels of home construction, a very substantial part of it financed by savings and loan associations whose assets grew on an average of about 15 percent a year.

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Had the business grown at a lower rate, say 5 percent a year, there would have been nearly $50 billion less in mortgage funds in the decade, or the equivalent of 3⅓ million housing units.

Of course, some of these units would have found financing elsewhere, but many of them just could not have been built—at least not without further Federal aids. Obviously, the rapid growth of the savings and loan business was vital to homebuilding and to the economy during the fifties.

Reserves of savings and loan associations have average about 8 percent of total savings during this decade. Had the reserve-accumulating authority been different than that permitted under the 1951 Revenue Act, it would not have been possible for these reserves to keep pace with the rapid growth in loan balances. Reserve ratios would have weakened, Federal and State supervisors would have properly intervened, and the growth of savings and loan institutions would have been severely restricted.

Essentially, therefore, one major question of broad public policy this Congress has to decide in determining a tax reserve formula for savings and loan associations is: To what extent should these institutions be asked to help meet the homeownership aspirations of the American people?

For our part, we believe that the public interest requires a reserve formula that will permit continued steady growth of savings and loan institutions and—as a result of this growth—the realization of homeownership opportunities for tens of millions of American families in the years ahead.

Bearing heavily on this point is the fact that the anticipated rate of new family formations between 1965 and 1970, as forecast by the Department of Commerce, will require an average rate of 1,633,000 new housing starts per year, approximately 50 percent greater than the current level of housing starts.

Were this Congress to adopt a tax law for savings and loan associations remotely resembling that recommended by the commercial banks, the need for various types of governmental aid to housing would reach unprecedented levels.

Costs to the Government and to American taxpayers of making up the funds lost to the private mortgage market would far exceed the tax revenues received from savings and loan associations.

It will be recalled in this connection that the Subcommittee on Housing of the Senate Banking and Currency Committee issued a special report on April 15, 1960, with respect to the housing needs of the future and the availability of credit to meet those requirements.

The subcommittee came to this conclusion: That mortgage requirements will be $160 billion for the decade of the 1960's and that the amount will be available "only if the past rate of savings and the proportion flowing into mortgages continues as in the past decade." Obviously a substantial change in our tax provisions will jeopardize that premise.

During most of the past decade the commercial bankers have been seeking to repeal the 1951 act and impose a tax reserve formula upon savings and loan associations which would be exactly the same as that imposed on commercial banks.

They talk about tax equality, but their main objective—diverting savings from our institutions into banks—has been poorly disguised. A prominent banker told the Treasury in a conference last summer that increased taxation of savings and loan associations—

will tend to reduce the dividend rates that they can pay somewhat and put us on a more competitive basis.

This banker went on to say, and again I quote:

We don't need to pussyfoot about that. That's really what we are interested in.

It should be apparent to everyone that the recent action of the Federal Reserve Board in authorizing commercial banks to increase their interest rates to 4 percent has had a vital effect on the savings and loan business, its operating margins and, of course, its ability to cope with increased taxation.

In some areas over the country the higher bank rate forced a dividend increase by savings and loan associations and even that increase was not sufficient to prevent a substantial loss of savings in many institutions in favor of savings departments of commercial banks.

Today the authorized commercial bank rate is 4 percent, and the typical savings and loan rate is 4¼, a gap of only one-fourth percent.

A year ago in most communities there was a difference of 1 full point between the rate the banks paid on savings and the rate our institutions paid on savings. This gap has been narrowed to only one-fourth percent in most areas and indeed in many cities, particularly along the eastern seaboard, our institutions now pay the same rate that the banks pay.

It remains to be seen just what long-term effect this narrowing of the rates between commercial banks and savings and loan associations will have, but it is obvious that the higher rates that we have had to pay in order to remain reasonably competitive with the banks has narrowed the operating margins to the point where a number of institutions right now—without any increased taxation—will find it quite difficult to meet the annual allocations to reserves required by laws and regulations.

While the withholding tax is a separate subject, it can be pointed out that this tax will add additional operating costs to our institutions and will serve as some deterrent to the inflow of savings. It would be a third blow, coming on top of the 4 percent bank rate and the increased income tax on our institutions.

Our institutions are concerned about the withholding question, and savings and loan witnesses will appear when this subject is before the committee.

Basically, our people believe it would be preferable to file additional information returns to the extent the Treasury finds it is feasible to process this information. We think that if the reporting requirement were reduced from $600 to $50, the great bulk of the dollars involved would be covered and it would still be feasible to handle that number of reports, particularly with electronic processing.

This combination of factors—greater bank competition, higher taxes and withholding—will inevitably hurt the ability of the savings and loan associations to perform their functions of providing adequate funds for home financing and, in some years, could mean little or no

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growth in our savings balances. Let me emphasize what it would mean for the savings and loan business to have a year of "no growth."

One-half of all the money we lend comes from new savings money and the other half comes from repayments of loans. If 1963 were to be a year of "no growth" for our business, for example, this would mean that we could lend $8 billion instead of $16 billion.

The $8 billion lost is the equivalent of 640,000 houses—nearly half of the 1,300,000 built last year. While we are not predicting the loss of 640,000 housing units as a result of higher savings and loan taxes and these other factors, this discussion does point up the fact that the loss to the housing economy cannot be measured in terms of the tax dollar we pay, but must be measured in terms of the savings diverted from our institutions.

Last fall we asked two prominent economists, Miles Colean and Dr. R. J. Saulnier (former Chairman of the Council of Economic Advisers), to make a study to the effect of a change in home construction levels, using 100,000 units as a convenient index.

As samples of their estimates, they computed that—among other things—100,000 housing units means a loss of $4.5 billion annually to the gross national product; $825 million in Federal income tax, and $410 million in State and local taxes.

Incidentally, the loss in Federal taxes from the loss of each 100,000 housing starts alone far exceeds that proposed to be collected from thrift institutions.

One of the principal purposes of the tax bill is to stimulate the economy and create more jobs. It seems highly inconsistent to include in that same measure a tax section which would slow down the economy and reduce employment. Why give a company which manufactures bathtubs a tax credit to modernize its equipment and produce more tubs and in the same bill reduce the demand for bathtubs by several hundred thousand units?

With the consent of the committee I would like to have the Colean-Saulnier study included as part of my statement.

The CHAIRMAN. Without objection.

(The study referred to follows:)

ECONOMIC IMPACT OF THE CONSTRUCTION OF 100,000 HOUSES

By M. L. Colean, R. J. Saulnier—A special study prepared for the U.S. Savings & Loan League, Chicago, Ill.

1. COMPOSITION OF THE IMPACT

The effect on the economy of the building of any given number of dwellings is far reaching, comprising, as it does, the following elements:

(*a*) *Direct construction expenditure.*—This includes outlays for manufacturing and distributing materials, for design of the houses, for job organization and direction, and for actual erection. The Bureau of the Census estimates that the average construction cost of a single-family house in 1960 was approximately $13,800.

(*b*) *Site improvements and utilities.*—Immediately related to the construction of the dwelling is the cost of site preparation and the installation of storm and sanitary sewers; water, gas, electric and telephone services; and streets adjacent to the property. The average combined outlay for these purposes may be put at $2,000 per house.

(*c*) *Other related construction.*—Any considerable volume of residential building creates the need for other types of construction. The possible magnitude of the related construction resulting from the building of 100,000 houses may be

judged by the fact that this is the equivalent of a city of the size of Omaha. For the purpose here, consideration need be given only to work most likely to be immediately stimulated by residential construction, such as local commercial and religious building and auxiliary street and utility construction. Such related work may be conservatively estimated at $3,000 a dwelling unit.

(*d*) *Related service expenditures.*—In connection with the purchase of a new house, there is a sales commission (or selling costs in some other form) and closing costs (recording fees, title fees, insurance, etc.) for which an average expenditure of $900 a house, made within a year, would not be unusual.

(*e*) *Related retail sales.*—The purchase of a house is certain to produce additional outlays for kitchen and laundry equipment not included in the construction cost, for shubbery, furniture, rugs and draperies, and for minor appliances. A figure of $3,000 a house is taken as a reasonable estimate for such outlays within a year after purchase of a house.

(*f*) *The multiplier effect.*—The economic impact of a given amount of residential building is not limited to the expenditure that directly results from this activity. The income that is received by individuals as a result of such expenditure appears again and again in the economy in the form of income to others as each set of recipients pays it out in consumption expenditures or taxes. Income that is saved also reappears as capital investment expenditures. To take account of these effects in a 1-year period coincident with and following construction, a multiplier of two of the expenditures estimated above may be used. Additional effects will be felt in later periods in amounts depending on the division of income between consumption expenditures and savings at any particular time.

2. THE GNP EQUIVALENT

Taking the above calculations in terms of the construction of 100,000 new single-family houses, the following estimate is obtained.

Expenditures resulting from the construction of 100,000 houses

Direct house construction	$1,380,000,000
Site preparation and utilities	200,000,000
Related construction	300,000,000
Sales and closing costs	90,000,000
Related retail sales	300,000,000
Subtotal	2,270,000,000
Multiplier effect	2,270,000,000
Total	4,540,000,000

This amount represents the contribution to the gross national product that could be expected, directly and indirectly, within a year's period, from the indicated volume of residential building.

3. DISTRIBUTION OF THE EXPENDITURE

The GNP equivalent of building 100,000 houses would be distributed as follows:

(*a*) *Taxes.*—In estimating the amount of Federal tax revenue accruing from an increment of GNP it is customary to take 18 percent or slightly more of the total product value, depending upon the estimated division of the additional income between compensation to employees and corporate profits. Applying the 18-percent figure to the above GNP equivalent results in estimated Federal revenue from personal and corporate income taxes of nearly $820 million.

For every $2 of Federal taxes, there is about $1 of State and local taxes.

The above estimates do not include payment for social security contributions.

(*b*) *Personal income.*—In 1960, disposable personal income (i.e., personal income after taxes) was equal to approximately 70 percent of the gross national product. The resulting amount was divided between consumption expenditure and saving on a ratio of close to 14 to 1. These relationships, applied to the housing expenditure (direct and indirect), result in an estimated personal disposable income of about $3.2 billion, of which just under $3 billion would be spent on consumption and about $210 million would be saved.

(*c*) *The residual.*—The remainder of the housing expenditure would largely appear as retained corporate earnings, most of which would be available for restoration or expansion of capital investment.

4. THE QUESTION OF TRANSFERENCE

The above calculations give a reasonable picture of the effect that would be produced by the erection of 100,000 single-family houses in a period of moderate economic expansion. The amount of economic loss that might follow a decline in construction of 100,000 houses involves other considerations.

Assuming no transference of labor and other resources to alternative uses, the loss in the first year would be equal to the total GNP equivalent above plus an allowance for loss of social security contributions and for increase in unemployment compensation. It is also possible, in theory, that the transference might be complete and therefore have no impact on income or taxation, but it would be dangerously unrealistic to make such an assumption for a period concurrent with and immediately following such a reduction in housebuilding activity. Some failure in transference is certain, even under the most favorable conditions.

Transference has to be considered in terms both of money transfers and transfers of resources. In all probability a large proportion of funds not used in financing houses would find other uses but the process would involve a considerable readjustment, and for some time, would be more apt to result in increased cash balances and the bidding up of prices of existing goods and services than in the increase of alternative forms of production. In any case, the transference of resources would be much slower than the transfer of funds. Alternative production would not automatically expand, simply because house production was curtailed. In fact, the reverse might well be the case. Moreover, the types of labor, the types of organizations, and many of the varieties of materials and equipment that are needed for housebuilding are not readily adaptable to other uses.

It is, therefore, resonable to conclude that so large a drop in housebuilding activity as that discussed here would have a gravely disruptive effect on the economy and tha the effect would extend over a considerable period of time.

LABOR REQUIREMENTS FOR THE CONSTRUCTION OF 100,000 HOUSES

The only authoritative data on the amount of labor for a given dollar volume of construction is that developed by the Bureau of Labor Statistics with reference to schools. This study shows that for every $1,000 of construction expenditure, there was an average of 84 man-hours of labor, with over half of the examples ranging between 75 and 95 hours. The study also indicates that there is 1.5 times the number of man-hours for offsite employment as there is for onsite employment.

In all probability, the man-hours of employment per $1,000 of residential building would be toward the top of the range mentioned above, or at least 90 hours. This would mean a little over 124 million man-hours of onsite construction labor for the $1.38 billion expenditure for 100,000 houses.

Assuming that an average "working year" of a construction worker would not exceed the equivalent of 45 weeks of 40 hours each, the total yearly hours per full-time worker would be 1,800 per year. The 124 million man-hours of work involved in 100,000 houses, then, means about 70,000 full-time onsite construction workers.

The use of the ratio of 1.5 offsite man-hours to 1 onsite results in a figure of 186 million offsite man-hours for the 100,000 houses under discussion. Since nearly two-thirds of the workers in manufacturing are reported to work full time 50 weeks or more, the "working year" for this group is a little longer than that for a construction worker—about 2,000 hours. The 186 million man-hours, then, represent about 93,000 full-time manufacturing workers.

On the basis of the above, construction of 100,000 houses would provide full-time employment for at least 163,000 persons.

Employing the same approach, the $500 million in site improvement and other construction related to the construction of 100,000 houses would involve 25,000 onsite workers and 33,750 offsite workers.

Altogether, therefore, about 95,000 onsite workers and about 127,000 offsite workers would be given a year's employment by the construction of 100,000 houses.

No attempt has been made to estimate the additional employment that would be generated by the purchases of furnishings made by new houseowners, or the employment developed as the effects of the initial expenditures for these and the actual construction work multiplied throughout the economy.

MATERIALS REQUIREMENTS FOR THE CONSTRUCTION OF 100,000 HOUSES

The quantities of materials and equipment on the attched table are derived from data compiled by the National Association of Home Builders, the Housing and Home Finance Agency, and the Bureau of Labor Statistics. Although these data were based on studies of 5 or more years ago, they constitute the only information presently available.

Changes in the characteristics of housing construction since these studies were made have undoubtedly increased the quantities of many of these elements. For example, evidence from the 1960 Housing Census would indicate that the number of plumbing fixtures per unit and the numbers of houses containing such elements as disposer units and air-conditioning equipment have substantially increased. Moreover, the above list does not include many common items of equipment such as refrigerators, automatic laundry equipment, and dishwashers. One hundred thousand new units of the type likely to be financed by the savings institutions would be almost universally equipped with these items.

It is also to be noted that no information exists as to the extent of use in new construction of types of heating equipment other than warm-air furnaces.

Selected materials and equipment involved in the construction of 100,000 houses

Material or equipment		Amount
Lumber and wood products:		
Lumber	million board feet	975
Finished wood flooring	do	115
Plywood	million square feet	104
Doors	millions	1.2
Window frames	do	1.4
Garage doors:		
Single	thousands	19
Double	do	23
Double 2-door	do	7
Other construction materials:		
Bricks	millions	470
Steel	tons	200,000
Cast iron	do	43,150
Copper	do	14,755
Aluminum	do	2,250
Cement	million bags	2.4
Paint	million gallons	1.9
Asphalt roofing shingles	million square feet	100
Wall and ceiling insulation	do	140
Gypsum wallboard and lath	do	500
Kitchen equipment:		
Cabinets	million units	1
Exhaust fans	units	55,000
Garbage disposer units	do	32,000
Other electrical equipment:		
Electric switches	million units	1.1
Convenience outlets	do	3.4
Lighting fixtures	do	1
Other flooring:		
Linoleum	million square feet	10
Asphalt tile flooring	do	20
Plumbing, heating, and related equipment and materials:		
Bathtubs	units	127,000
Water closets	do	156,000
Warm-air furnaces	do	73,000
Air conditioners	do	7,000
Ceramic tile	million square feet	11

THE PREVENTIVE ROLE OF RESERVES

There is another aspect of this question of reserves which I think this committee will want to consider: That is the preventive nature of

savings and loan reserves; their function as a bulwark against the kind of difficulties which might occur in a prolonged economic slump.

There are those who contend that there is no need for large savings and loan reserves because such a period will never happen again. True, we may never again suffer so severe a depression as the 1930's. But the essential point to bear in mind is that the savings and loan associations, which this country depends upon for the bulk of its home mortgage credit, could be damaged severely by a much less serious slump than a generation ago.

Prior to 1930, the typical mortgage loan made by a savings and loan association was 65 percent of the value of the property and you may remember that the typical term was 11 years and 7 months. Now, 80-percent loans, running for 20 to 30 years, are commonplace, and there is a growing amount of 90-percent mortgage lending.

The present day combination of higher percentage, longer term loans simply means that the principal of these loans is repaid much more gradually over a much longer period of time and, hence, the risk on these loans is much greater than it was a generation ago.

It is important to note that the housing philosophy of the Federal Government in the postwar years has been one of encouraging homeownership through the liberalization of mortgage credit.

The Congress repeatedly has written that philosophy into our housing legislation and the Government, by word and deed, has fostered liberal lending policies calculated to extend homeownership to more and more families.

Surely there is a basic inconsistency in a policy which encourages liberal loans by the savings and loan associations on the one hand and seeks to curtail their reserve protection on the other.

Obviously, the fact that savings and loan losses on mortgage loans have been at a minimum in recent years is no assurance that such losses may not occur in the future.

From the close of World War II until 1960 we were passing through a period of acute housing shortage, when demand consistently outran supply, and there was an uninterrupted inflation in the housing field as in all other areas of the economy. In such a period, losses, of course, were negligible; the housing shortage and inflation provided built-in protection for lenders.

In the past 18 months, however, this situation has changed substantially. I would like to call your attention to figures of the Federal Home Loan Bank Board which reveal a disturbing trend upward in the number of foreclosures. I would also like to emphasizes that the figures gathered by the United States Savings & Loan League on delinquencies disclose that there has been a dramatic rise in delinquencies in the last 2 to 3 years.

In pointing to these figures we do not suggest that a wave of foreclosures similar to that of the early 1930's is about to crash down on us. But we do suggest that there are storm signals which should be studied carefully in any consideration of the need for reserves by savings and loan associations.

The savings and loan associations in this country have a vital role to play in the lives of our people and our communities. Substantial reserves mean not only the ability to remain solvent in times of stress, but also the ability to extend leniency to small homeowners and continue useful operations needed by a community in periods of recession.

LOAN DIFFERENCES AND RESERVES

As the committee knows, the entire case of the commercial bankers for "tax equality" is based on their claim that we should have the same 2.4-percent reserve ratio the banks have.

Commercial banks are diversified and essentially short-term lenders. We are single-purpose, long-term lenders. The application of the 2.4-percent reserve against a bank's entire portfolio dramatizes the fact that by far the greater part of this portfolio is of much shorter term than the loans of a savings and loan association.

This fact, and particularly the large number of short-term loans in the bank's portfolio, gives the bank an ability to increase its reserve ratio to its total loans at a much faster rate than can a savings and loan association, which it would of course do if it saw economic problems ahead either for the Nation as a whole or in its own area.

By way of example, applying the 2.4-percent reserve against 90-day notes only the reserve ratio as against these notes could be converted into a 10-percent, 50-percent, or 200-percent reserve in 90 days by the simple device of not renewing and not making new 90-day notes. On most 90-day notes principal is totally recaptured within the tax year. Thus a bank can protect itself rather quickly in the event of economic distress, but a savings and loan, with much longer term loans, would not have anywhere near this ability.

It is obviously inappropriate to apply the same formula to the 90 percent of value, 20- to 30-year home loans of the savings and loan association. Almost no principal is recaptured in the first 3 years of a 25- to 30-year home loan.

To tax total interest payments as profit without adequate allowance for attrition of capital would be reckless optimism. There is no way to rapidly multiply the reserve ratio against these loans by not relending the money. The money is already loaned, some of it for the next quarter of a century.

I repeat, that in the first years of a 25- to 30-year home loan there is very little paid on the principal of the loan.

In years when house prices were rising almost every year this might have been of little concern. Now, however, with the inflation bias removed from real estate, depreciation again becomes evident and in the early years of a long-term loan normal depreciation may well exceed the buildup in equity.

If you add a drop in house prices as a result of economic distress in a community, or a radical change in the character of a neighborhood, to the normal depreciation which we are now experiencing again in real estate, many of our loans could well exceed by substantial margins the market value of the property. Whenever the amount of the loan exceeds the market value of the property, we have a dangerous situation and a loss potential.

Much of the income on which the banks pay their corporate taxes is earned by the investment of their demand deposits, which is free money, including enormous amounts of free money from the Government.

Any other corporate enterprise has to pay for the money it uses. If a withholding tax is imposed, savings and loan associations will deposit more than half a billion dollars of our withheld dividends each

year in the commercial banks, who will add it to their tax and loan accounts, the huge balances of which banks use to generate corporate profits. They will pay nothing to anybody for the use of our savers' dividends, as they pay nothing now for the use of the Government's money in these accounts. Banks pay no interest at all on two-thirds of their deposits. We pay for every cent of our savings accounts. Banks do invest heavily in tax-exempt securities. Federal savings and loan associations, and most State chartered associations, are not allowed to invest in tax-free municipals.

In the 5 years ending in 1960, the banks averaged a money cost of only 73 cents per hundred dollars of invested assets. We had to pay more than four times as much.

In the face of all this, the banks know, as we know, that a tax on the thrift institutions based on the reserve allocation designed for short-term portfolios would be an unfair and punitive tax.

In ending this section, I would just like to remind the committee that the only phase of commercial banking which is really comparable to the savings and loan business is the savings department of the bank.

We have made a special study of the operations of the commercial banks' savings departments and find that this phase of commercial banking pays little or no income tax. The tax paid by commercial banks is generated almost entirely by the commercial and demand deposit end of their operations, which is not comparable to a savings and loan association.

This analysis of the sources of taxes paid by commercial banks is contained in the pamphlet entitled "The Real Issue," the basic text of which I would like to include in the record.

The CHAIRMAN. Without objection the insertion will be made.

(The pamphlet referred to follows:)

THE REAL ISSUE

The real issue in the tax controversy is not the taxes paid by the commercial banking business as a whole versus the taxes paid by the savings and loan business as a whole. The real issue is the tax revenue produced by the savings departments of commercial banks versus the tax revenue produced from savings and loan associations which deal only in savings.

The only true comparison is between the savings department of a commercial bank and a savings and loan association.

Comparing the taxes of a commercial bank as a whole and a savings and loan association is like comparing a large manufacturing concern with an independent retail store. They are alike only in that they handle dollars.

The only true comparison can be between the savings department of a commercial bank and a savings and loan association.

The bankers talk about tax equality and complain about the savings and loan tax law. Their criticism would be valid only if the savings department of a commercial bank produced substantially more tax revenue than a savings and loan association holding a comparable amount of personal savings.

But the cold, hard fact is that savings departments of commercial banks will produce in 1962 little or no tax revenue. On the next six pages are data supporting this statement. This information is, we submit, pertinent to congressional consideration of our tax dispute with the commercial banks.

Commercial bankers frequently claim that a commercial bank pays more in direct taxes than does the savings and loan association. How can it be otherwise when (1) the direct taxes paid by commercial banks are derived almost entirely from the "commercial end" of the banking business, including the trust department, and not from savings department operations, while (2) a savings and loan association does not and cannot engage in commercial banking type activities?

No matter how you cut it bank savings departments will not produce taxable income in 1962.

Commercial bankers long have complained about the savings and loan tax law but have been remarkably quiet about the fact that their savings departments pay little, if anything, in taxes. The commercial bankers refuse to discuss the operations of their savings departments as distinguished from the rest of the bank.

Why are they reluctant to provide data on the investment of savings and the income and expenses of their savings departments?

Because these figures show that little or no direct Federal income taxes are paid as a result of the operation of the savings departments of commercial banks. The primary income tax produced by the banks' savings departments is the taxes paid by the savers themselves on the interest they receive from their savings deposits.

Reproduced below are illustrative statements of the investment of bank savings, department savings showing various possible combinations of investments of bank savings deposits.

Also shown is projected taxable income in 1962 from these investments and the allowable deductions from gross income.

Note that no combination of savings department investments produces direct taxable income.

Bank savings invested in this manner—

[In thousands of dollars]

	A	B	C
Mortgages (including home loans)	$3,500	$4,750	$6,000
State and local government bonds	2,000	1,600	1,200
Consumer loans	1,800	1,300	700
Commercial loans	1,400	1,050	800
Cash in bank including Federal Reserve banks	800	800	800
U.S. Government securities	500	500	500
Total	10,000	10,000	10,000

WILL PRODUCE THIS AMOUNT OF GROSS TAXABLE INCOME

	A	B	C
Interest on:			
Real estate mortgages at 5½ percent	$193	$261	$330
Consumer loans at 10 percent	180	130	70
Commercial loans at 5½ percent	77	58	44
Cash in bank including Federal Reserve banks	0	0	0
U.S. Government securities at 3 percent	15	15	15
Loan fees and other charges	15	15	15
Total	480	479	474

AND AFTER THE FOLLOWING DEDUCTIONS FROM GROSS INCOME

	A	B	C
Interest payments to savers at 3.7 percent	$370	$370	$370
Operating expenses [1]	100	100	100
Allocations to bad debt reserve	10	10	10
Total	480	480	480
Will produce this amount of taxable income in 1962	0	0	0

[1] Operating expenses are calculated at 1 percent of total savings funds. This is an operating expense cost lower than for a savings and loan association of comparable size. The expense ratio for a comparable savings and loan association is approximately 1.2 percent.

THE 1960 STORY

Bank taxes came primarily from the commercial end of the business.

One major reason commercial banks may be unwilling to give profit-and-loss statements for the operations of their savings departments is this: They are fully aware that these departments produce little direct income tax—the same criticism they make of the savings and loan business.

Official banking figures show that in 1960 time deposits produced less than 2 percent of the total taxes paid directly by commercial banks despite the fact that time deposits accounted for almost $1 out $3 of total bank deposits.

Using 1960[1] statistics of the Federal Deposit Insurance Corporation, it is possible to isolate and thus reconstruct income and expense figures for the savings departments of FDIC-insured commercial banks as distinguished from the commercial end, including the trust departments, of these banks.

The table produced to the right shows conclusively: First, bank savings departments produce little taxable income, and, second, bank income tax payments are produced largely by the demand deposits and other commercial functions of the bank.

THE 1960 RECORD OF SAVINGS ACCOUNTS AND FEDERAL INCOME TAXES

Tax income account of all insured commercial banks segregated by type of deposit [1]

[In thousands of dollars]

	Demand deposits, 68.4 percent of average 1960 total deposits	Time deposits 31.6 percent of average 1960 total deposits
Taxable income:		
Interest on U.S. Government securities [2]	$1,432,273	$358,068
Interest on other bonds, notes, and stocks	60,969	28,167
Interest, discounts, and fees on loans	4,656,200	2,151,110
Service charges on deposit accounts [3]	589,954	0
Service charges—other [4]	196,709	21,857
Trust department [3]	460,251	0
Recoveries, transfers from reserve accounts	393,181	181,645
Other current income (includes safe-deposit vaults, foreign exchange, etc.)	190,385	87,955
Total taxable income	7,979,922	2,828,802
Allowable deductions:		
Interest paid on time deposits	0	1,785,086
Interest paid on borrowed money	59,771	27,614
Salaries, wages, and fees [5]	2,545,029	309,229
Losses and chargeoffs	669,241	309,181
Other operating expenses [5]	1,846,376	359,715
Total deductions	5,120,417	2,790,825
Net taxable income	2,859,505	37,977
Federal income taxes paid	1,283,888	17,052

[1] The following footnotes are an integral part of this statement. Commercial bank accounting, unfortunately, does not provide a precise statistical basis for segregating the income and expense of the savings department. Consequently, certain assumptions concerning segregation of accounts have been made. Income and expense items are allocated to time and demand deposits on the basis of the ratio each represents to total deposits except as specifically indicated in the following notes.

[2] Based on assumption that major portion of more liquid U.S. Government securities represent demand deposits. 80 percent of this type of income was allocated to demand account and remaining 20 percent to time account.

[3] Since this item does not apply to the time deposit function, it was applied entirely to demand deposits.

[4] Since this item usually is not a time deposit function, the income has been allocated on the basis of 90 percent to demand deposits and 10 percent to time deposits.

[5] Salaries, wages, and other operating expenses were allocated on basis of data on cost of running a savings function at a savings and loan association. Data used represent operating experience of Federal Home Loan Bank member associations in 1960. Wages and salaries are computed at 9.8 percent of gross operating income, and other expenses are computed at 11.4 percent of the same. Gross operatng income differs from taxable income in that nontaxable income is included in gross operating income.

Source: FDIC Annual Report, 1960.

But direct taxes are not the whole story. When indirect taxes are counted, it is seen that about the same amount of tax revenue is produced by a commercial bank and a savings and loan association of comparable size.

Bank savings departments produce tax revenue in a manner similar to a savsavings and loan association.

The demand deposit function of the commercial banking business is quite different from the operation of a savings and loan association and quite different from the operation of a commercial bank savings department. Yet each type of business produces about the same amount of revenue to the Federal Government but in a different manner.

[1] The latest year for which figures are available.

The tax revenues produced by the savings department of a commercial bank are taxes paid essentially by the savers on the interest income they receive. The same is true with a savings and loan association.

On the other hand, the commercial or demand deposit end of the commercial banking business produces taxes in quite a different way simply because the nature of the business is essentially different. The savings operation is technically that of a financial intermediary—"buying" money from the public and lending it out. The commercial end of the banking business is that of a credit-creating organization. It does not pay for its money. Deposits are created essentially by the credit process. Trust departments, of course, charge a service fee for the services rendered.

Of great significance, however, is the fact that the savings and loan business and the commercial banking business produce about an equivalent amount of revenue considering the relative sizes of the two businesses—but each in a different way. The table on the next page gives the story.

Why commercial banks seek savings deposits:

Question: Since its savings department typically does not produce taxable income, why does the commercial bank provide a savings deposit service?

Answer: For a variety of reasons including (1) to accommodate commercial customers, (2) to recruit commercial banking business from savings account customers, and (3) for profit.

This profit motive stems in large part from the fact that savings deposits can be invested in tax-free State and municipal bonds. To a commercial bank in a 52 percent tax bracket as a result of its commercial banking operations, the investment of savings deposits in tax-free State and municipal bonds is highly profitable. The yield on a 3¼ percent municipal bond to most banks is equivalent to the yield on a 6½ percent mortgage loan.

Comparative taxes produced by a typical savings and loan association and a commercial bank, both with assets of $10 million, projected for year 1962

	Typical savings and loan association with $10,000,000 in assets	Typical commercial bank with assets of $10,000,000	
		Commercial end of bank operations	Savings department operations only
Savings or deposits, year end	$8,600,000	$6,000,000	$3,200,000
Interest and dividends:			
Interest or dividends on savings [1]	351,700	0	109,540
Dividends on common stock [2]	0	22,305	11,905
Total, interest and dividends	351,700	22,305	121,445
Federal income taxes: Estimated taxes paid by savers and stockholders—20 percent of interest and dividends	70,340	4,461	24,289
Actual taxes paid direct by institutions [3]	670	44,760	850
Total, Federal income taxes	71,010	49,221	25,139
Total, Federal income taxes	71,010	74,360	

[1] Computed on basis of 4¼ percent on average savings in associations and 3.7 percent on average time deposits in banks.

[2] Projected on basis of a 5-year trend in dividends paid on bank capital stock and distributed according to deposit ratios.

[3] It is assumed that the taxable income of the banks in 1962 is the same as in 1960.

Sources: Data of savings and loan associations and commercial banks are projected on the basis of 1961 preliminary figures and on actual data of prior years as published in "Combined financial statements of members," 1960, by the Federal Home Loan Bank Board and in the "Annual report," 1960, of the Federal Deposit Insurance Corporation. Savings in savings and loan associations and time deposits in banks are projected on basis of trends in the savings/assets ratios.

Facts to remember:

1. Savings and loan associations are vastly different financial institutions than commercial banks because banks have far broader powers and privileges.

2. A savings and loan association performs only those functions performed by the savings department of a commercial bank.

3. Neither the savings and loan association nor the savings department of the commercial bank produces much tax revenue directly. However, both provide substantial tax revenues through taxes on earnings received by savers.

4. A commercial bank pays substantially more taxes directly than does a savings and loan association, but only because of its commercial deposit function and other powers not available to savings and loan associations.

5. The most significant fact is that the savings and loan business and the commercial banking business produce directly and indirectly almost the same amount of tax revenue, but each in a different way.

And a final question: Should a savings and loan association be asked to pay substantially higher taxes to the Federal Government when its counterpart in the commercial banking field—the savings department of the commercial bank—pays little or nothing?

Mr. BUBB. It includes tables showing how bank savings are invested, the taxable income produced from these investments, the deductions allowed, and the resulting minor tax from the commercial bank savings department.

CHANGES ASKED IN H.R. 10650

Although we feel that the tax equality issue as advanced by the commercial banks is totally without basis, we do recognize that there are sincere persons in and out of Congress, not connected with commercial banking, who believe that an industry the size of the savings and loan business should pay more income tax than under the current laws.

However, we honestly and sincerely believe that a tax of the magnitude of the House bill would have most serious consequences. Therefore, we urge a modification of the tax formula incorporated in the House bill.

One such modification, for which there is precedent, would be a transition period. The House proposal imposes more than a 2,000-percent increase in corporate taxation of savings and loans. This is an extremely large increase. If it should develop that the burden on the business is too great, a transition period would enable the Congress to correct the situation. Even with such a phase-in, very substantial revenues would be produced from the first year.

Our figures show that had the House bill formula been in effect in 1961, some 500 associations would have been unable to make the required supervisory allocations to reserves, and thus would have become supervisory cases. At best these institutions would have suffered a loss of public confidence, and possibly more severe consequences. If 500 financial institutions are in trouble, then there will be repercussions touching the entire financial system.

A transition period would give these institutions more time to adjust or work out satisfactory merger arrangements with stronger institutions, because if—after these associations have put the required amount into reserves—they do not have enough money left over to pay a competitive dividend, they will face slow liquidation.

In asking for a transition period we are asking for a fair opportunity to adjust to the impact of a major tax increase which, even with the transition period, would represent increases of a size rarely if ever imposed on any financial system.

In addition to this change in substance of section 8, we recommend some changes in the legislative language. Of the most importance is

that which has to do with the basic definition of a savings and loan association.

Federal savings and loan associations are chartered and supervised by the Federal Home Loan Bank Board under the Home Owners' Loan Act of 1933. State chartered associations which meet the standards and apply for membership are insured by the Federal Savings and Loan Insurance Corporation. This insurance program was established by the Congress in the National Housing Act of 1934 and is supervised by the Federal Home Loan Bank Board whose three members are appointed by the President and confirmed by the Senate.

We feel that any savings and loan association which is a member of the Federal Savings and Loan Insurance Corporation should automatically qualify as a savings and loan association for tax purposes.

After all, they are operating under legislation enacted by the Congress for savings and loans and I think we can assume that the Federal Savings and Loan Insurance Corporation is not going to admit to membership any organization that is not a "true" savings and loan. All that would be necessary to accomplish this would be to make certain changes in the qualifying language at the bottom of page 54 and apply it only to paragraph (B) which relates to the uninsured savings and loans.

We also feel that some of the language is unnecessarily complicated. None of our institutions intend to use the experience reserve method which is provided as a third alternative in the House bill and we see no valid purpose in including this alternative. At least it should be made crystal clear that those associations using the 60–40 alternative or the 3 percent of loan growth alternative will not have to go to the trouble and expense of computing their tax under the experience alternative. We would be happy to work with the committee and the committee staff in an effort to simplify the language.

In conclusion, I would remind this committee that Congress has a long tradition of encouraging the development of savings and loan institutions. This has been done in the belief that this type of financial organization is essential to the broadening of thrift and homeownership opportunities for millions of American families.

Our mission in life is to assist American families in all walks of life to buy homes. We earnestly hope that the congressional decision on the tax law will not place an insurmountable obstacle to our performing this job.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Bubb.

You state that in addition to this change in substance of section 8 you recommend some changes in the legislative language.

Have you copies of those amendments?

Mr. BUBB. Yes, sir.

The CHAIRMAN. Will you supply them? The Chair would be glad to insert them in the record.

Mr. BUBB. Thank you, sir.

(The amendments referred to follow:)

DEFINITION OF DOMESTIC BUILDING AND LOAN ASSOCIATION

"Domestic building and loan association," as set forth in the Internal Revenue Code and as proposed to be amended in H.R. 10650, should be revised to read as follows:

Beginning on page 54 of the House bill (March 12, 1962), change lines 9 through 25, and lines 1 through 7 on page 55, to read:

"(c) DEFINITION OF DOMESTIC BUILDING AND LOAN ASSOCIATION. Paragraph (19) of section 7701(a) (definition of domestic building and loan association) is amended to read as follows:

"'(19) SAVINGS AND LOAN ASSOCIATION.—The term "savings and loan association" means a savings association, a savings and loan association, a building and loan association, and a homestead association which—

"'(A) is an insured institution within the meaning of section 401(a) of the National Housing Act (12 U.S.C., sec. 1724(a)), or

"'(B) is subject by law to supervision and examination by State or Federal authority having supervision over such associations, if its business consists principally of accepting savings and investing (i) in loans or interests therein secured by an interest in real property which is (or from the proceeds of the loan will become) residential real property, and (ii) in other loans and investments, to the extent such other loans and investments would be authorized to be made by a Federal savings and loan association under section 5(c) of the Home Owners' Loan Act, as amended (12 U.S.C., sec. 1464(c)).

Wherever in the Internal Revenue Code of 1954 the term "domestic building and loan association" appears, the same is amended to read "savings and loan association"'"

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. I would like to ask the witness if he is opposed to any increase of taxation on saving and loan associations?

Mr. BUBB. No, sir.

Senator DOUGLAS. That is, you would favor some increase?

Mr. BUBB. Yes, sir.

Senator DOUGLAS. You feel, therefore, that the savings and loan associations have not paid adequate amounts in the past?

Mr. BUBB. I wouldn't want to put it that way, Senator Douglas. We feel that as long as the Congress feels that we should change the tax formula we have had in the past, and there is a need for this money, as good Americans we want to go along with that feeling. We want to pay a tax we can afford to pay without closing too many of our associations.

Senator DOUGLAS. I was trying to read between the lines of your statement. I would like to ask this question to find out if it is explicit that you are not so much opposed to the amount of the tax in the House bill as to the fact that it goes into effect all at once and you would prefer to have this put into effect by steps, is that correct?

Mr. BUBB. That is correct, sir; yes, sir.

Senator DOUGLAS. What would you suggest on the time period?

Mr. BUBB. Well, we thought somewhere between 3 and 5 years; possibly paying half of the tax the first year, the other half over—spread out over a period of years.

That would give the Government a considerable sum of money right off to start.

We have many small associations, Senator, as I pointed out in my testimony, that are going to have a difficult time adjusting to this and that is why we feel that some period of working up to this full tax as set out in the House bill would help tremendously.

Senator Douglas. Do you take any position as to whether the reserve, assuming that it is properly defined, should be 4 percent or 5 percent, rather than 3 percent?

Mr. Bubb. No.

Mr. Strunk. Are you referring to the 3-percent arrangement in the law?

Senator Douglas. Yes. The complaint is made that some of the recently established building and loan associations are accumulating reserves and while the average rate of building and loan associations as a whole is slightly over 8 percent, some of the associations which have been established in the last few years will have difficulty in meeting the 3-percent limit.

Do you have any comment?

Mr. Strunk. I would say, Senator Douglas, under the bill, the House version, they could get the 3 percent without any trouble.

Their problem would be getting beyond the 3 percent. They would have to pay a tax on the 60–40 basis once they reach that 3-percent figure and to the extent——

Senator Douglas. I understand.

Mr. Strunk (continuing). And to the extent that the committee would raise that at least for new institutions it, of course, would be extremely helpful to them because they will have real difficulty in accumulating adequate reserves, particularly in competition with the institutions that are big and already have those reserves.

Senator Douglas. Do you have any suggestion?

Mr. Strunk. One suggestion would be to raise that to 3½ or 4 percent, for example. That would help them a lot.

Any one point on top of 3 percent in the House bill would be very helpful

Senator Douglas. Is it true that the Federal law and Federal administrative regulations set 5 percent as the minimum ultimate goal to be obtained in 20 years?

Mr. Strunk. The Federal savings and loan insurance statute requires that institutions insured by the FSLIC must build reserves to 5 percent by the end of the 20th year of insurance, and these are the things that bother these institutions.

Beyond that the insurance corporation requires that institutions build reserves, the ultimate goal is 12 percent.

They build reserves after their 20th year and their 5-percent mark by putting in a certain amount of their income before dividends into reserves each year. It is this requirement that Mr. Bubb referred to as to which many institutions would find it hard to meet.

Senator Douglas. Has your association taken any position on withholding? I noticed that the witness passed over that with a very glancing phrase.

Mr. Bubb. Let me say this, first, Senator Douglas. We expect and hope and want every American citizen to pay the taxes that they owe.

Senator Douglas. But——

[Laughter.]

Senator Douglas. Go ahead.

Mr. Bubb. I will use your word "but."

Senator Douglas. I knew it was coming.

Senator Gore. He was using yours. [Laughter.]

Mr. BUBB. We feel that the same job can be done by reporting to the Treasury of the United States the amount of dividends paid to our savers, say, of $50 a year or over or any other figure that they will agree to supervise by sending a copy of that report to the Treasury to the saver. Psychologically when you send the report of that copy out to the saver they are going to report it.

Now, we feel that with the new electronic processing that they put into operation, if they would ask the savings and loans, banks, and other people to cut down this $600 to $50, we will say, or even to $10, if they want to do it and to report those annually, sending a copy of this form to the saver, the Government will get all the money that they will get on withholding without the extra expense and difficulty and all the people coming in and filing exemptions.

We don't think that is too hard a "but."

Senator DOUGLAS. Well, I have gone into this matter with the Collector of Internal Revenue and he states that their investigations indicate that withholding will collect more than three times as much of the unreported taxes as your proposal even with an automatic data processing system. It would collect more than three times as much, and do it at two-thirds of the cost.

Mr. BUBB. Well, the reason they say that they have never tried it at less than the $600. We don't have to report anything under $600 a year now.

If we would get it down to $50 or even $10, if they want it, I think they would get the same amount of tax in with less cost and less difficulty.

Senator DOUGLAS. Wouldn't that require a great deal of administrative work both on your part and on the part of the Government?

Mr. BUBB. It would certainly require a lot more than it does now, but if it gets the tax dollars in we feel it would be worth that and we certainly would be glad to do our part.

Mr. STRUNK. May I comment on that, Senator?

Senator DOUGLAS. What is your objection to withholding? What is your objection?

Mr. BUBB. Well, one objection to withholding is that some people who haven't been paying this tax are going to take their money out and put it in the mattress or in a tin can or in savings bonds or transfer it somewhere else. We are going to have some loss in funds.

Senator DOUGLAS. Everyone else will be withholding.

Mr. BUBB. It doesn't make any difference. Savings bonds won't be, for instance and even though everybody else is withholding some people will take it out of my association and put it in somebody else's so they can't trace it back. There is going to be some transfer of funds. But the really scared person is going to take it and put it back in the tin can and bury it or under the mattress.

Senator DOUGLAS. You have a low opinion of the American public.

Mr. BUBB. Well, for those few that is my opinion. The other——

Senator DOUGLAS. Now, just a minute. There is a system of withholding from wages and salaries, isn't that true?

Mr. BUBB. That is correct, sir.

Senator DOUGLAS. It seems to work prety well.

Mr. BUBB. It works pretty well because a person has to have a job. They don't have to save their money with you.

That is one objection.

Senator DOUGLAS. Wherever they go they will find withholding, whether they take the wing of the morning and fly to the outermost parts of the sea, as the Bible says, even there will withholding follow them.

Mr. BUBB. That is true, Senator, except their lockbox or mattress—and we have had several people tell our tellers that is what they are going to do if this goes in. The last 3 years we have been sending a slip to every saver telling them they should report those savings for income tax purposes.

Now, the savings and loan business has sent out 16 million of those slips the last few years. We think that has been a great improvement in the collection procedure. We think it would be a much greater improvement and probably get all the money they could by withholding by this new system of reporting down to $50.

Mr. STRUNK. May I comment on the reporting system, Senator Douglas?

I think the facts show—you know corporations report every dividend over $10. Our institutions and the banks and others report every interest payment or dividend payment over $600.

Senator DOUGLAS. Let me see, with an interest rate of 4 percent that would require——

Mr. STRUNK. A very large account.

Senator DOUGLAS. It would require a $15,000 account.

Mr. STRUNK. That is correct. So as a practical matter we——

Senator DOUGLAS. Three percent would require a $20,000 account. What proportion of your accounts are that large?

Mr. STRUNK. Very few, we make very few returns. But I think the facts show the corporation dividends, a much higher proportion of the corporation dividends, are reported on personal income tax returns than the proportion of interest payments by savings banks, interest payments by commercial banks and our institutions, and I think the reason, one reason, is that most corporate stockholders understand that their dividends are being reported to the Treasury, so there is a psychological motivation for that man to report his dividends on his income tax return.

They know we are not reporting, and I think the psychology is, if we are not reporting on them then they won't put it in their income tax return but if the corporation is telling the Treasury the amount of his dividends then they would report it.

I know that Commissioner Caplin has indicated that machines have never been built to collect taxes—they merely will state what taxes are owed. And it is true that under automatic data processing here that you won't get quite the amount that—because the machine can't go out and see me or anybody else and get this money but I think that the psychology of reporting our dividends will mean that people are going to report those interest and dividends payments on their personal income tax return.

Senator DOUGLAS. Let me ask this question: Mr. Bubb said that the depositors would withdraw their savings, bury their savings in the backyard.

Senator GORE. In a tin can.

Senator DOUGLAS. In a tin can.

In this way, they would get no interest and no earnings whatsoever. Do you mean to say that rather than get 80 percent they would prefer to get nothing?

Mr. STRUNK. Of course, they would be cutting off their nose to spite their face.

Senator DOUGLAS. Exactly. But there is the argument of your president.

Mr. STRUNK. I think what Mr. Bubb meant is they would take it out——

Senator DOUGLAS. Let Mr. Bubb explain what he means. [Laughter.]

Mr. BUBB. What I meant was that a few of the savers that would be scared to start reporting when they hadn't been reporting for fear the Internal Revenue would pick them up and fine them for back taxes owed, they would do that.

Senator DOUGLAS. Wouldn't they be afraid of that under your system of giving receipts?

Mr. BUBB. No, I don't think they would, Senator, because that type of person doesn't follow it that far through to that conclusion, I don't think.

Senator DOUGLAS. So you think that rather than have taxes withheld on interest or dividends, these people would draw out their savings in cash, put it in a tin can, bury it in the yard, and get nothing?

Mr. BUBB. A few of them.

Senator DOUGLAS. How many?

Mr. BUBB. Well, I wouldn't know. That would be anybody's guess.

Senator DOUGLAS. Any substantial number?

Mr. BUBB. Compared to the total number of savers, no. I wouldn't say it would be substantial.

Senator DOUGLAS. In other words, not a substantial number.

Mr. BUBB. Possibly, yes.

Senator DOUGLAS. Not a substantial number. Well, if it is not a substantial number this is not a substantial objection.

Mr. BUBB. I didn't say it was a substantial objection, Senator. You asked me the various reasons and I was telling you the reasons that our tellers have picked up from savers.

Senator DOUGLAS. I know. Well, I wouldn't say that was overriding in importance then. That is all.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Bubb, I might say as one who has had reservations about the advisability of the withholding on interest, whether it would be practical or not, I cannot follow your reasoning that it should be deleted from the bill on the basis that the depositors will withdraw their money and put it in tin cans. I must say I cannot follow along with you on that because I accept that as a valid argument, in my opinion, which would be in favor of the withholding.

Mr. BUBB. Let me say I think I have blown that all out of proportion. That was only one of the things we have picked up. I was trying to tell my friend the Senator from Illinois which customers had complained to us about it.

I think the greatest reason for not having the withholding tax is like I stated, that it can be accomplished with much less trouble to the American public, to the people who collect the taxes, and to the savers, by doing it on the reporting system than on the withholding system.

Senator WILLIAMS. Well, on this reasoning, I am not quarreling with you because as I say, I did have and still have many reservations as to the advisability of the proposal.

Now, one question: If the provisions of the House bill are enacted as they were brought over to the Senate without change, at what rate would your organizations then be required to pay taxes on your net income?

Mr. BUBB. We would pay on a 60-40 basis. That would be, we would pay 52 percent on 40 percent of our income.

Senator WILLIAMS. And approximately at what rate do you figure that would be, as compared with——

Mr. BUBB. I think the House estimated it at $200 million a year.

Senator WILLIAMS. I am speaking of a rate, an average rate.

Mr. BUBB. Well, the rate would be about 20 percent.

Senator WILLIAMS. About 20 percent?

Mr. BUBB. Yes, sir.

Senator WILLIAMS. On an average.

I notice that you have this statement from which I quote:

> The House proposal imposes more than a 2,000-percent increase in corporate taxation on savings and loans.

If that is over a 2,000-percent increase in the present rate, would that mean that you are now paying less than 1 percent?

Mr. BUBB. Yes, that is correct.

Mr. STRUNK. May I point out, Senator, you say 20 percent, that would assume that every dollar after our dividend disbursements is net income. That ratio used would not recognize the need or the fact of any reserves.

Most of what we have or all of what we have in the minds of many, after our expenses and our payments to savers, is appropriate for allocations to reserves and is not net income.

Now, the House bill would recognize that 60 percent of that would be appropriate necessary cost of doing business and 40 percent would be under the House bill taxable income, you see.

Senator WILLIAMS. I was not raising any assumptions, I was just asking the question. If you are increasing over 2,000 percent, increase in what you are presently paying, and if after that 2,000-percent increase it would bring it up to a 20 percent, then the assumption is that you are now paying less than 1 percent of tax on your income.

Mr. STRUNK. That is correct. One percent of our income after expenses and dividends.

Senator WILLIAMS. After expenses; well, that is what we figure income, after expenses, that is all we ever tax, anyway. No one, whether it be savings and loan or commercial banks or anybody, is paying taxes on their expense income.

Mr. STRUNK. Yes, sir; but part of your expenses is a set-aside for losses, so what we talk about, if we include expenses as including necessary allocations to reserves for bad debts.

Senator WILLIAMS. And as I understand it, you recognize that the existing law tax rate is too low, is that correct?

Mr. SLIPHER. I think we recognize that we have paid very little direct income tax, less than $10 million.

Senator WILLIAMS. And you are recommending that there be some change in existing law and that be increased is that correct?

Mr. SLIPHER. We recognize the need for revenue and the sentiment of Congress that the amount we are paying now is not acceptable. We don't attempt to defend it for the future. We want to work out some arrangement where we can pay some more taxes and not an excessive amount.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Senator Smathers?

Senator SMATHERS. No questions at the moment, Mr. Chairman.

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Mr. Chairman, I have two questions: the first one grows out of Mr. Bubb's testimony and in asking it, I am trying to get some important information into the record.

On page 12 you say—

We feel that any savings and loan association which is a member of the Federal Savings and Loan Insurance Corporation should automatically qualify as a savings and loan association for tax purposes.

Now, if we broaden the definition as suggested, what additional kinds of organizations will be included that are not included in the bill as written now.

Will the number of organizations to be included go up or down?

Mr. BUBB. Well, there would be no organization included that are not included now. It is merely to simplify the language and keep from having difficulties with thousands of Internal Revenue people out in the field interpreting the law as written by the House bill.

I would like to ask our special counsel, though, to answer that further, if I might, Senator.

Mr. McKENNA. Senator, this is a vital matter to us, not because of the inclusion or exclusion of taxpayers, but because of the enormous uncertainty in the present statute.

Right now, we must have substantially all of our business involved in the making of loans to members. Now, when we say "substantially all" we are taking a concept which the Treasury otherwise applies as 90 percent, and yet we know for practical operations we ought to have perhaps 10 percent of our assets in cash and bonds in order to take care of contingencies and further, in this making loans to members, this is an archaic phrase. We know what our function is now. It is prescribed by Congress. We are directed by the supervisory authorities to construct tract houses, that is one of our basic functions.

But historically that concept of making loans to members means a single loan to one homeowner, so that it does not fit the proper operations of a savings and loan today at all.

The words "substantially all" are a danger to the whole business because we are in the hands of the tax agents who themselves don't know what that means.

We don't want to include anybody who is not a proper savings and loan but we feel very strongly that when supervisory authorities say we are operating properly and we are doing what the Government wants us to do we shouldn't then be faced with a tax agent's theory that we should be making only single family loans to one man and not taking the risks involved in tract operation.

It is the uncertainty that is bothering us.

Senator BENNETT. Would this language automatically exclude any savings and loan association that was not a part of the Federal Savings and Loan Insurance Corporation?

Mr. McKENNA. We certainly don't want it to. We want it to include them also if they are properly operating as savings and loans and we think it is too restrictive and too uncertain as to them, too.

Senator BENNETT. I am talking about the language you recommend. You say, "We feel that any savings and loan association which is a member of Federal Savings and Loan Insurance should automatically qualify."

Mr. McKENNA. We feel that, Senator, but we also feel uninsured associations should be included. We recognize some standards must be set for uninsured associations because the membership in the Federal Savings and Loan Insurance Corporation is not available as a standard to them.

Senator BENNETT. Would there be a different standard applied to them than to the insured?

Mr. McKENNA. To the extent possible we want to put in that second standard, the one applicable only to noninsured institutions, a description of a proper operation of a savings and loan association, that part must be interpreted by the tax agent.

We feel as far as the insured associations are concerned if the Government is willing to insure the accounts it should recognize the savings and loan associations. It is a difficulty of expressions of words.

Senator BENNETT. You want one standard but you are willing to let the committee write in language for the noninsured savings and loan associations; however, you want an automatic qualification for an insured association?

Mr. McKENNA. That is true, Senator, subject to this: that we feel that this language is grossly unfair to the uninsured associations, too, and we would like to make it a reasonable definition as to them.

Senator BENNETT. Have you suggested language which you consider to be a reasonable definition for the uninsured?

Mr. McKENNA. We have, informally we have, suggested language several times in different alternatives. We have language which we can submit to the committee. (See p. 1380.)

Senator BENNETT. It is a little difficult for me to see how, if you can suggest language which you think will take care of the uninsured people, the same language can't apply to the insured?

Mr. McKENNA. It gets down to this, Senator: if the Government is insuring its accounts and if it is supervising the association, we would rather see the supervision in the appointed supervisors, the arm of Congress, than in the tax agents.

When we get to the uninsured association there is no place else for it to be so far as the Government is concerned and we recognize that there must be more discretion in the tax agents. It gets down to that.

Senator BENNETT. Well, this is an interesting idea that because one agency of Government operates in the field then the existence of that agency and the relationship with that agency automatically applies to a certain group of people who may actually be a little different and that may not quite come under the definition that you are setting up for these noninsured people under some circumstances.

Mr. McKENNA. We hope that is not the case. We hope that there are more rigid standards required by the Insurance Corporation than would be required in the separate category but we want them to be required by the Insurance Corporation.

Senator BENNETT. I think maybe this committee has to look pretty hard at the idea that you have a dual definition, one for a particular group and another one for those who for some reasons decide not to belong to that group. This is a problem.

Mr. McKENNA. Senator, this is not, of course, the all-important thing. The all-important thing is the unlivability of the definition as applied to both categories right now.

Senator BENNETT. And that, as you expressed earlier, is the requirement that savings and loan associations must build their assets on loans to their members——

Mr. McKENNA. In the present 7201 it is a requirement that substantially all of their business be confined to the making of loans to members having in mind the history that could possibly mean single loans to single homeowners which is totally inconsistent with our function today.

In the bill, as it is, as it passed the House, we have similar difficulties.

First we have substantially all, which means as the Treasury has otherwise applied it 90 percent of its business consists of accepting savings and investing the proceeds.

Well, we have to have some percentage, perhaps 10 percent, in liquidity in order to function as a savings and loan and we must perform other functions so this definition "substantially all" is unacceptable.

Senator BENNETT. You construe this to mean if you had cash in a vault which represented 11 percent you would be in violation of the law.

Mr. McKENNA. We don't construe it that way. We would like to eliminate the possibility that the Treasury Department will say if we have 11 percent in U.S. Government bonds we are not a savings and loan.

Senator BENNETT. Could you supply the committee with a list of the activities in which savings and loans engage which you consider to be outside of the present definition.

Mr. McKENNA. Let me put it this way, Senator. This is an area of doubt rather than an area in which we will concede that it is outside the present scope of the definition.

Basically, of course, tract lending, we feel that tract lending, is a proper operation of savings and loans. We recognize the contention that it is not. What we are talking about is an area of doubt, rather than an area of exclusion and inclusion.

Senator BENNETT. Does the Federal Savings and Loan Insurance Corporation put any limits on you as to how your money can be invested.

Mr. McKENNA. They do in every examination. They go over the operations of savings and loan. Every time it is exposed to them, every time it is examined annually and they make their determinations as to whether those operations are safe and sound and I hope also the language of the Insurance Act of whether or not it is a savings and loan and whether or not it promotes economical home financing.

Senator BENNETT. Well, do they have any set of prescribed standards which limit the manner and pattern of your investments or does an examiner just look at each institution and in his own judgment decide whether or not this particular pattern is safe in this particular case?

Mr. McKENNA. I would hope it is some way in between, Senator. That there is some national pattern to it and also a recognition of the rights of State-chartered associations to act in conformity with their own State laws because there is an element here that the State should have some discretion as to the operations of their own associations.

As to Federals, I would expect that the Federal authority would exercise more rigid controls.

Senator BENNETT. For the record, are State-chartered associations permitted to insure their loans under the Federal Savings and Loan Insurance Corporation?

Mr. McKENNA. They are, and basically this is an insured industry, Senator. When we talk about the uninsured we are talking about a rather small volume of assets, but they are rather important.

Senator BENNETT. Has the amount of business you have been doing in these unrelated areas or these areas outside of the definition in the bill been increasing or decreasing?

Mr. McKENNA. Well, again, it is an area of doubt.

We do a lot of tract financing now. It is very possible that 30 years ago these same words in the definition and in the Internal Revenue Code would have been interpreted to exclude tract financing. We think they should include them today because this is one of our essential functions.

We don't know what position Internal Revenue will take on this important issue and it is awfully important to us. It is not an area of inclusion or exclusion. It is an area of insufferable doubt and we want that resolved.

Senator BENNETT. If you could figure out a way to resolve the insufferable doubts that other taxpayers have to face, maybe by including them by definition, by a broad definition and by relating them to another phase of the Federal law, this might be a good solution. But it bothers me a little because it is a situation which seems to me to be removing all discretion from the Internal Revenue Department and putting it over into another agency which can change its rules without respect to the tax laws. We may get a little bit on Dean Rusk's grounds with this automatic inclusion.

There is another question which grew out of the testimony heard yesterday, and I would like to give you as a representative of the savings and loan industry a chance to comment on a statement that was made by Mr. Gormley yesterday afternoon.

He said, and I am quoting—

> The report of the Federal Home Loan Bank Board on earnings of insured savings and loan associations does not set out specific figures reflecting losses experienced by savings and loan associations. One can only conclude that any loss experienced by these associations is set out in an item known as "nonoperating charges." The total of such nonoperating charges does not in any year in the past 10 years amount to as much as 1 percent of their net earnings.

Now, to translate that into a simple question, is Mr. Gormley correct in saying that in no year during the past 10 have the losses ex-

perienced by insured savings and loan associations been as much as 1 percent of their net income?

Mr. BUBB. Well, of course, Senator Bennett, Mr. Gormley is talking about, and he knows it, the fact that during the past 10 years we have had tremendous inflation which I pointed out in my testimony today. There was a shortage of houses. With inflation and a shortage of houses naturally you are not going to have the loss in housing you could have.

But I can assure you that for the next 10 years, at least from the last 10 months anyway or for the next few years as far as we can tell, it is going to be a different story. Foreclosures are increasing very rapidly. They are at their highest point since the last depression; delinquencies are up two or three times what they were 2 or 3 years ago, and it isn't a fair comparison to make.

As I have said before, the savings and loan business has cyclical losses. You have got to build reserves for the time you will have those losses. You don't take them as you run along by month to month as you can on 90-day notes and 6-month notes.

Senator BENNETT. You don't think a 10-year cycle is a broad enough cycle to measure your cyclical losses?

Mr. BUBB. Not the 10 years Mr. Gormley is talking about; no, sir.

Senator BENNETT. Would you like to put into the record—let me go back and ask my question again.

Is Mr. Gormley's statement correct for the past 10 years?

Mr. BUBB. For the past 10 years I would say it was. It is one of the few statement that he made that is correct. [Laughter.]

Senator BENNETT. I didn't think that the relationship between the banks and the savings and loan associations had deteriorated to the point where you were calling each other liar.

But would you like to put into the record the loss ratio for the previous 10 years and let's say the thirties and the forties as well as the fifties?

Mr. BUBB. Yes, we will be very, very happy to submit a full memorandum, Senator.

Senator BENNETT. And since you have said you expect the loss ratio to rise sharply in the years ahead, do you want to stick your neck out and estimate what you think the loss ratio is going to be over the next year or two?

Mr. BUBB. We will be very happy to put it in a memorandum.

Senator BENNETT. That is all, Mr. Chairman.

Mr. BUBB. We appreciate your asking that question. It is a good one and something that should be part of the record.

Senator BENNETT. Thank you.

That is all, Mr. Chairman.

(The information referred to follows:)

MEMORANDUM RE LOSSES ON REAL ESTATE LOANS

There is no specific statistical series of data which directly reflects the losses on real estate loans by savings and loan associations Even statistical data which might bear on the subject is not uniformly available for the entire period from 1930 to the present.

However, there have been a number of studies which throw considerable light on this question and are useful in attempting to measure the magnitude of real estate losses and the need for reserves.

These studies all relate to the 1930's because, as emphasized by Mr. Bubb in his testimony, losses on real estate lending are cyclical and are concentrated in the recession and depression phases of the cycle. During the 1940's and 1950's the prices of houses were almost constantly rising. This inflation more than offset normal depreciation so that even a 100-percent loan had a safety cushion. Foreclosures were extremely rare and generally the result of a family breakup rather than a decline in the value of the real estate. Thus, real estate loan losses during this period of time have little significance in evaluating the need for loss reserves.

Senator Bennett referred to the statement of a previous witness, Mr. Gormley, with respect to the item in the financial statement entitled "Nonoperating Charges." An inquiry at the Federal Home Loan Bank Board develops the information that this item is not a measure of real estate losses. While some real estate losses are included under this category, the Board informs us that real estate losses are primarily handled by adjustments to surplus, undivided profits, and reserve accounts. These would be ascertainable by examining individual institutions' records but the Federal Home Loan Bank Board does not mention combined figures of these adjustments.

One of the most comprehensive investigations of savings and loan losses in the 1930's was conducted by the U.S. League's Director of Research, Don M. Dailey and, unlike many studies, involved an examination of actual books and records of institutions. It showed that 42 percent of the associations in the five areas studied suffered losses of 10 percent or more. That study is attached to the main part of the record.

Another significant study is that made by Dr. Raymond Goldsmith, and an excerpt from his book is attached to the main part of the record.

The most directly relevant statement from the Federal Home Loan Bank Board on real estate losses is contained in a memorandum by Chief Supervisor John M. Wyman and was part of the hearing record of the House Ways and Means Committee. His statement is attached.

The former savings and loan commissioner of the State of California studied the real estate losses by savings and loans in California and that study is attached.

We hope that these materials are useful to the Senate Finance Committee in its deliberations with respect to section 8 of the pending bill.

Summary of Five Loss Studies by the U.S. Savings & Loan League

Don M. Dailey, director of research; Lee E. Duss, Jr., assistant

The following tabulation summarizes the results of our association loss analysis which we have thus far made in five areas.

Altogether, 335 institutions have been studied on a year-by-year basis covering the depression years of the 1930's.

As many as 17 percent of those associations reveal losses of 20 percent or more of their 1930 mortgage loan balances; 30 percent show a loss of 15 percent or above, and altogether, 42 percent reveal losses of 10 percent or more.

The 335 associations reported assets at the outset of the depression amounting to $647 million; 17 percent of these assets were those of institutions showing losses of 20 percent or above; 32 percent were those of associations with a loss figure of 15 percent and over. Altogether, almost one-half (48 percent) of the aggregate assets were represented by institutions revealing a loss of 10 percent or above.

Depression loss experience—Savings and loan associations in Milwaukee, Wis., Kansas City, Mo., and in Michigan, Indiana, and West Virginia (total loss as percentage of 1930 mortgage loan balance)

Percentage of loss to 1930 mortgage loan balance	Savings and loan associations		Asset distribution	
	Number	Percentage of total	1930 assets (thousands of dollars)	Percentage of total
Less than 5 percent	142	42.4	$239,554	37.0
5 percent and less than 10 percent	52	15.6	93,353	14.4
10 percent and less than 15 percent	39	11.6	107,162	16.6
15 percent and less than 20 percent	44	13.1	96,422	14.9
20 percent and over	58	17.3	110,408	17.1
Total	335	100.0	646,899	100.0

NOTE.—The 335 institutions covered in the above tabulation comprise the major portion of all savings and loan associations in the areas indicated. The sources used were the published reports of supervisory authorities as well as the records in the files of those officials; also numerous personal interviews were made. The analysis involved a year-by-year loss study covering the decade of the 1930's for each institution. The league's research department has a copy of the case study of each association included in the analysis.

STUDY OF DEPRESSION LOSSES: SAVINGS & LOAN ASSOCIATIONS IN KANSAS CITY, MO., AND MILWAUKEE, WIS.

There never has been an adequate study of depression losses in the savings and loan business. The only clue to losses we have had has been the reports of State supervisory departments and in many cases they have been inadequate. Detailed charges to reserves are not usually published in the reports of State supervisory authorities and at best one can deal only with totals and averages.

One handicap in studying depression losses based upon published supervisory reports is the fact that savings and loan institutions in so many areas underwent substantial reorganization and there was no consistency in publishing the record of associations which were placed in receivership or liquidation. Many of the institutions disappeared completely, and in numerous cases the major losses suffered by the savings and loan business were those of institutions that disappeared and of which no published record exists as to the losses taken.

In order to get a fair and as complete picture as possible of the losses in the savings and loan business in the depression, it is necessary to make a detailed study of each institution which was in business at the beginning of the depression. This, of course, is impossible for every institution in the country, but with the cooperation of State supervisory authorities and depending upon the availability of reports in the Federal supervisors' files it is possible to make such a study of our institutions in certain cities.

As a start and to develop a sample pattern for such city-by-city studies, the research department of the U.S. Savings & Loan League has made a study of the depression experience of our institutions in Milwaukee, Wis., and in Kansas City, Mo., although in the case of the Kansas City study we were handicapped by the fact that the records of some of the institutions were destroyed by water damage to the State supervisor's office in Jefferson City.

Vital to an analysis of depression losses is the determination of the bookkeeping practices of the institutions involved during this period. This is necessary in order to measure the losses taken by the institutions. We found that the accounting practices of Kansas City and Milwaukee associations in handling repossessed real estate and in recording losses was for the most part similar. While there were exceptions, the typical practice was for these institutions to take real estate in foreclosure on their books in an amount equal to the unpaid balance of the loan together with the amount of unpaid interest and foreclosure costs.

The practice in the handling of income and expense in connection with real estate owned seemed to vary somewhat, but in the main the accounting procedure followed orthodox lines; namely, ordinary expenses of operation were taken as an expense rather than capitalized while major capital improvements to the property, as proper accounting procedure dictated, were charged to the account or capitalized. Rental income was taken into the income of the association and not subtracted from the capitalized value.

Upon sale of the real estate, reserve accounts were charged for the difference between the then book value of the real estate, including commissions and similar charges, and the purchase price. Institutions carried a variety of reserve accounts, and the loss reserve accounts were known by a wide variety of names, but we were able in the main to separate the true loss reserve accounts from liability reserves and reserve accounts other than pure surplus reserves.

We believe that with very few exceptions losses suffered by the associations upon eventual sale of the real estate were charged to loss reserve accounts. There were a few instances of properties being sold for more than the book value and profits on the sale were shown as additions to the reserve accounts.

There were a few instances among the Kansas City institutions of the records indicating that losses upon the sale of real estate were carried to the expense account rather than as a charge to the reserve account, and profits were reflected in the income account rather than as a credit to the reserve account. In these instances we have recast the accounts, showing such losses as debits or credits to the reserve accounts, thus presenting, we believe, an accurate picture.

The above technique of studying the debits and credits to the surplus reserve accounts as a measure of the losses was adequate for all institutions studied in Kansas City. These transactions were followed in the case of the Kansas City associations for the years 1931 through 1942 or 1943 by which time most of the real-estate-owned accounts had been liquidated or wartime activity had brought values up approximately to book value. This technique was, however, not possible for all of the Milwaukee institutions in the years after 1939 and after 1940 in the case of others. A statement of the technique followed to determine the post-1939 losses taken by the institutions in the two cities is, thus, appropriate at this point.

In the case of the Kansas City institutions, 21 were studied in detail as these were the institutions for which the complete data were available in the files of the supervisory department. Of these 21, there were 12 which underwent reorganization.

The reorganization plan typically involved determination by either the Federal or State supervisory authority or both as to those assets which were good and those which were bad or of doubtful character. The good assets were placed in another association or merged with the good assets of other institutions into a newly organized association, the accounts of which were insured by the Federal Savings and Loan Insurance Corporation.

The bad or doubtful assets, consisting in the main of real estate owned, were placed into liquidating trusts. The proportion of assets placed in liquidating trusts ranged from 20 to 80 percent. Addendum A shows the detailed record of the Kansas City institutions with respect to reorganization practice.

In the case of those assets deemed to be good and placed in new, insured, going institutions, the assumption was made that there were no losses suffered on those assets subsequent to reorganization. This is an assumption that errs on the side of understating the losses because we know, although we do not have the records to substantiate it, that the insured associations suffered losses on some of the real estate they took from the reorganizing institutions.[1]

In the case of those assets of the reorganized associations placed in liquidating trusts, records are available which show the losses taken on such assets up to and including 1943. While all of the assets in such liquidating trusts had not been completely liquidated by the end of 1943, it is assumed that all, or substantially all, of the losses had been taken by that time.

In the case of the institutions which did not go through reorganization, the records of their debits and credits to reserve accounts were studied through 1943.

Thus in the case of the Kansas City institutions the loss record is a complete one if one assumes that all of the losses were taken by 1943, a reasonable assumption but one that, if anything, results in a slight understatement of the losses.

In the case of the Milwaukee institutions, there were 79 in existence at the end of 1930. Of this number, 33 were reorganized (addendum A). It is necessary to understand the situation which prevailed in Milwaukee during the latter years of the 1930's and the actions taken by the State and Federal supervisory authorities in connection with these institutions.

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[1] A prime example here is the record of the Safety Federal Savings & Loan Association and also the Swedish American Savings & Loan Association, both of which required a contribution from the Insurance Corporation to make up losses on those assets assumed from the reorganization, assets deemed to be good at the time of reorganization.

With very few exceptions, all of the Milwaukee institutions were frozen; i.e., they were not paying any withdrawals or in only restricted amounts. All of them held substantial amounts of real estate. There had been some sales of real estate owned as a result of foreclosures, but many institutions had not really begun to dispose of their real estate.

There was instituted under a new banking commissioner in 1939 a complete reorganization program for the Milwaukee institutions. In cooperation with the Federal Savings and Loan Insurance Corporation each institution was studied and a reorganization plan was worked out for each of those not considered entirely insurable by the officials of the FSLIC. Those not considered completely insurable were studied as to the reorganization required and a determination made as to what portion of the assets could go into a new institution or what plan of merger of the assets of several associations into one new insured institution would be appropriate.

There was, as a result of this study and program, a complete appraisal made in 1939 and 1940 of the value of the assets of nearly all of the Milwaukee institutions. These appraisals were made for the State supervisory department and the FSLIC. They were market value appraisals, and subsequent sales of real estate substantiated the validity of these appraisals as an estimate of the market value of the real estate owned by the Milwaukee institutions in 1939.

Addendum B gives the detail of the segregation between good and bad assets of those associations reorganized and the amount by which the book value of the real estate owned by these institutions was written down.

The loss record, then, of those Milwaukee institutions which went through reorganization was developed from a study of the net charges to the reserve accounts in the years prior to 1939 or 1940 (developing upon the reorganization and the appraisal date) and the difference between the book value and the appraised value of the property on hand at the reorganization date as a measure of the losses not yet "taken" by this date.

In the case of those institutions which did not go through reorganization, and those whose real estate holdings were not appraised, it would have been preferable to study the net charges to the reserve accounts up to the war years as was done in Kansas City. Detailed records, however, are not available subsequent to 1939 or 1940.

While the institutions which did not go through reorganization did not have significant amounts of real estate owned in 1939 or 1940 when they were insured, they did have some and a few had rather substantial real estate holdings. From discussions with savings and loan people it is clear that much of the real estate of these nonreorganized institutions still on the books in 1939 or 1940 was not worth the book value. To arrive at complete losses, then, it is necessary to make some assumptions as to the value of the real estate owned in 1939 and 1940 of these nonreorganized institutions.

For want of a better method, the ratio of the 1939 appraised value to the 1939 book value in the case of the Milwaukee savings and loan real estate that had been appraised was applied to the real estate owned by these nonreorganized institutions. The total loss record of these institutions consisted, then, of the net debits to their surplus reserve accounts prior to 1939 or 1940, depending upon the availability of records plus the assumed net loss on the real estate still owned by these institutions in 1939–40.

It should be noted that in the case of both Milwaukee and Kansas City the reports necessary to determine the actual debits and credits to the reserve accounts were not available for years prior to 1935 in the case of Milwaukee, and prior to 1933, 1934, and 1935 in the case of various institutions in Kansas City. Thus aggregate net debits to reserves reflect no such debits in years prior to 1935 in Milwaukee and generally 1935 or 1934 in Kansas City. Savings and loan associations in these cities did not dispose of their foreclosed real estate and thus did not take many of their losses prior to 1935. Again, losses were not considered as taken and no debit to the reserve account was made until the real estate had been liquidated. Thus this is not a serious omission, but if anything, it results in an understatement of the losses.

It should also be noted that in the case of loans in default transferred to the Home Owners' Loan Corporation in exchange for HOLC bonds, there were two types of losses taken by associations as the result of such transactions. In most cases the HOLC gave to the mortgagee bonds in an amount somewhat less than the unpaid balance of the loan and the accumulated unpaid interest. Thus at the time of the transfer of the loan to the HOLC there was some loss taken. This loss was reflected by a debit to a reserve account.

It will also be recalled in the early days of the HOLC program that the bonds of the Corporation were not guaranteed as to interest and principal by the U.S. Treasury, and as a result they had a market value less than par. A number of associations sold these HOLC bonds at less than par, and this further loss in the HOLC transaction typically was charged to the reserve account.

Addendum C shows the record of the institutions in Milwaukee. These institutions are shown by number rather than by name, but the name of each institution is available on a restricted basis from the research department of the U.S. Savings and Loan League. These institutions are listed in the order of their total percentage loss, losses being computed as a percentage of net mortgage portfolio (gross portfolio in the case of Kansas City associations).[3]

Table I which follows presents a summary of the losses taken by each of the Milwaukee institutions, i.e., it summarizes the data in the last column of addendum C.

TABLE I.—*Depression experience in Milwaukee savings and loan associations: Total loss as percentage of year-end 1930 net mortgage loan balance*

Percentage of loss to year-end 1930 net mortgage loan balance	Savings and loan association	
	Number	Percentage of total
Less than 10 percent	7	8.9
10 percent and less than 15 percent	18	22.8
15 percent and less than 20 percent	24	30.4
20 percent and less than 25 percent	13	16.4
25 percent and less than 30 percent	10	12.6
30 percent and over	7	8.9
Total	79	100.0

Source: Addendum C.

Addendum D presents the loss record of those institutions in Kansas City the records of which were available and which were analyzed.

Table 2 summarizes these findings.

TABLE 2.—*Depression experience of 21 Kansas City savings and loan associations: Total loss as percentage of August 1930 mortgage loan balance*

Percentage of loss to August 1930 mortgage loan balance	Savings and loan association	
	Number	Percentage of total
Less than 10 percent	12	57.1
10 percent and less than 15 percent	3	14.3
15 percent and less than 20 percent	1	4.8
20 percent and less than 25 percent	1	4.8
25 percent and over	4	19.0
Total	21	100.0

Source: Addendum D.

NOTE.—Losses comprise total net charges to loss reserves from the sale of real estate owned and mortgage loans. In the case of 4 institutions "writedowns" in loans in 1936-38 were included as losses.

[3] To understand the concept of "net mortgage loans," some description of the operating practices of savings and loan associations prior to the depression is necessary.

Many institutions in the 1920's made loans on what was known as the "sinking fund" or "cancel and endorse" plan. A typical sinking fund loan was repaid by the borrower not by making payments directly on the loan but by accumulating in a share account or savings account to which regular payments were made so that the balance in the account eventually equaled the balance of the loan at which point the share account would be canceled off against the loan.

In the case of a cancel and endorse loan, the savings account was canceled off against the loan at varying times instead of only when it equaled the amount of the loan. Thus a portion of the savings accounts in an institution represented amounts accumulated by borrowers as payments against their mortgage loans and pledged to the repayment of the loan. The loans were therefore overstated by the balances in such pledged accounts.

The concept of "net mortgage loans," then, is total loans outstanding less the balance in the shares that were being accumulated by the borrowers in payment of their loans.

In the case of Kansas City institutions it should be noted that data covering net mortgage loans are not available except in the case of a few institutions and therefore gross mortgage loan figures are used.

Such statistics as we have in Kansas City indicate that the pledged shares amounted to something from 1 to 8 percent of the total shares outstanding as of 1936. Probably at the end of 1930 the average of pledged shares to total shares was around 20 percent. In the case of the Milwaukee institutions we know that the aggregate pledged shares outstanding at the end of 1930 was approximately 25 percent. Thus the mortgage loan accounts of the Kansas City associations at the end of 1930 is overstated by anywhere from 15 to 25 percent and it follows that the ratio of losses to mortgage loans are understand by several percentage points.

The aggregate or average loss for the entire group of Milwaukee institutions was 17.9 percent of the net mortgage portfolio as of December 31, 1930. The aggregate or average loss of the entire group of 21 Kansas City institutions was 18.1 percent of the August 31, 1930, loan balances.

The 100 Kansas City and Milwaukee institutions represented in this study had total surplus reserves at the end of 1930 of $7,486,000 representing 4.4 percent of the mortgage loans outstanding at that time (net mortgage loans outstanding in the case of the Milwaukee institutions). In case of the Kansas City associations alone the ratio amounted to 8.9 percent. It should be noted that this is not as small a figure as many students of the business might have assumed that institutions had at the beginning of the depression, yet this reserve was obviously inadequate. The Milwaukee and Kansas City institutions froze up and, as will be noted later, there was a distressed market for the passbooks representing savings in these associations.

It should be noted further that if every one of these institutions had had a loss reserve of as much as 20 percent, 35 out of the 100 would have had inadequate reserves to meet the losses of the depression.

While the above represents an accurate statistical record of losses suffered in the savings and loan business in these two cities in the depression, there are other loses suffered which cannot be measured and which, admittedly, were borne by savers and borrowers and not by the institutions themselves.

These losses were of several types. The most obvious was that suffered by the saver when in desperation for cash he sold his passbook in the open market. Until reorganization in the early 1940's none of these institutions was a going concern and paying withdrawals in full. Many of them were paying limited amounts, such as $50 or $100 per month, but numerous savers and investors needed more cash or, despairing of the future, took what they could get at the time. There was a well organized market for the shares of savings and loan associations in Milwaukee. Quote sheets similar to quotations today of securities listed on the open market were published by brokerage firms in that city. The following is a copy of an offerings sheet published by W. L. Rittel & Co., on May 1, 1936.

Building and loan stocks

	Approximate market
Acme	65-67
Advance	69-71
Aetna	75-77
Alliance	38-39
Arrow	35-38
Assurance	26-28
Atlas	72-75
Badger	78-81
Bahn Frei	65-68
Bay View	69-72
Ben Franklin	81-83
Biltmore	69-70
Bluemound	65-68
Capitol	47-50
Center Street	42-44
Central	18-20
Citizens' Mutual	87-90
City Savings	30-33
Civic Mutual	61-63
Columbia	60-62
Community	73-75
Concordia	71-74
County	53-55
Cream City	47-50
Cudahy Savings	53-55
East Side	75-77
Economy	68-70
Equitable	74-75
Excelsior	81-83
Fidelity	80-81
First Bohemian	74-76
First Slovak	73-76
Forward	65-68
Great Lakes	38-40
Green Bay Avenue	83-85
Greenfield Avenue	61-63
Guardian	62-64
Guaranty	57-60
Highland Park	82-85
Holton Street	66-69
Home Mutual	70-72
Hopkins Street	85-88
Integrity	74-76
Jackson	55-58
Keystone Mutual	67-69
Kinnickinnic	72-74
Lakeside	65-67
Layton Park	78-80
Liberty	67-70
Lincoln	57-60
Lisbon Avenue	40-42
Marquette	85-88
Metropolitan	78-80
Milwaukee Mid-City	69-71
Mitchell Street	72-74
Modern Mutual	74-76
Mutual	80-82
National	77-78
North Avenue	82-84
North Shore	84-85
Northern	85-87
Northwestern	88-90
Peoples	71-73
Pioneer	67-69
Progressive	65-68
Prosperity	68-71
Pulaski	74-78
Pyramid	69-71
Reliance	79-81
Republic	69-71
Residence Park	67-70
Riverside	69-71
St. Francis	83-86
Second Bohemian	74-77
Security	79-82
Sentry	70-71
Sherman Park	80-82
Slovak	52-54
Sobieski	48-51
South Side Mutual	77-79
Standard	78-80
State	57-60
Sterling	72-75
Suburban	72-74
Tippecanoe	15-18
United	77-78
Upper Third	66-69
Washington	64-66
Wauwatosa	78-80
Waukesha Savings	74-76
Waukesha Ind	74-76
Welfare	66-67
West Allis	80-82
West Side	65-68
White Eagle	74-76
Wisconsin Savings	79-80

It will be noted that shares typically were sold at discounts of 20 to 30 percent and estimates have been made that of the total of $140 million in shares of these institutions in 1930 no less than 15 percent were disposed of by the savers in the open market. Thus some of the savers took very substantial losses and, again, this type of loss is not reflected in the previously cited data.

It should also be noted that these institutions without exception reduced their dividend rates, in many cases substantially. Whereas the typical dividend rate in Milwaukee and Kansas City in the late 1920's was 5 percent, with the onset of the depression the rates were reduced to as low as an average of from 2 to 3 percent. In a number of institutions, particularly those in Kansas City, no dividends were paid during the depression years prior to the reorganizing of the institutions.

To the extent that there was a segregation of assets there were no current dividends paid on that portion which was absorbed by the liquidating corporation. As a result, then, of the depression and the institution's having inadequate reserves, the savers took a substantially lower rate of return and in some cases received no return. This is another type of loss.

There were particularly unfortunate losses in the case of mortgage pledged shares, i.e., the share accounts that were being accumulated by the savers in anticipation of building up a share account equal to the amount of the loan. The interest rate on the loan had been set in anticipation of a 5 to 6 percent dividend rate being paid on the shares. When the dividend rate on the shares was substantially reduced, the effective cost to the borrower increased proportionately.

It should also be noted that the sale of the real estate owned was facilitated to some extent (and higher prices received for association real estate and lower losses reflected on the books) as the result of the practice in some cases of people, including speculators, buying up association passbooks on the market at discount prices and tendering them to the institution as part payment in the purchase of the repossessed real estate with the association taking the passbook at par value.

It should also be noted that almost without exception in both cities the real estate owned by the association was sold not for cash but on land contracts at minimum downpayment and frequently no downpayment. If the real estate market had not improved rapidly as the result in 1939 and 1940 and subsequently in great part as the result of the war, much of this real estate sold on no downpayment or land contract would have come back to the institutions. In other words, the association sold real estate and took back a land contract under terms it would never have considered in making a real estate mortgage loan.

ADDENDUM A.—*Depression experience of 21 Kansas City savings and loan associations: Reorganization practice (institutions listed according to assets)*

Association	Assets, August 1930 (in thousands)	Reorganized, yes or no	Percentage of assets placed in liquidating trust	Association	Assets, August 1930 (in thousands)	Reorganized, yes or no	Percentage of assets placed in liquidating trust
1	$12	No		12	$1,020	No	
2	39	No		13	1,434	No	
3	100	Yes	50	14	1,550	Yes	50
4	119	No		15	1,939	Yes	80
5	144	No		16	2,629	Yes	70
6	219	Yes	50	17	2,865	Yes	80
7	330	Yes	60	18	3,063	Yes	75
8	336	No		19	3,124	Yes	60
9	376	No		20	3,544	Yes	75
10	704	Yes	85	21	8,377	Yes	20
11	813	No					

Source: Reports from individual institutions which handled liquidating trusts.

ADDENDUM B.—*Depression experience of Milwaukee savings and loan associations: Institutions placed in liquidation by supervisory authorities*

[Listed according to assets]

Association	Assets, Dec. 31, 1930 (in thousands)	Reorganized, yes or no	Percentage of assets placed in liquidating trust	Write down of book value of real estate
1	$71	No		
2	95	Yes		(1)
3	107	No		
4	153	Yes		(1)
5	218	Yes		$26,804
6	294	No		
7	320	No		
8	338	No		
9	353	No		
10	354	No		
11	356	No		
12	360	No		
13	365	No		

See footnote at end of table.

ADDENDUM B.—*Depression experience of Milwaukee savings and loan associations: Institutions placed in liquidation by supervisory authorities*—Con.

[Listed according to assets]

Association	Assets, Dec 31, 1930 (in thousands)	Reorganized, yes or no	Percentage of assets placed in liquidating trust	Write down of book value of real estate
14	$379	No		
15	419	No		
16	503	Yes		$8,636
17	539	Yes		80,935
18	620	Yes		35,759
19	660	No		
20	705	No		
21	771	No		
22	789	No		
23	789	No		
24	794	No		
25	797	No		
26	801	No		
27	857	Yes	50	47,849
28	926	Yes		49,153
29	931	No		
30	941	Yes	50	75,248
31	996	No		
32	1,019	No		
33	1,168	No		
34	1,171	No		
35	1,190	Yes		(1)
36	1,202	No		
37	1,211	No		
38	1,273	Yes		179,336
39	1,276	No		
40	1,330	No		
41	1,334	No		
42	1,406	Yes		252,637
43	1,407	Yes		252,563
44	1,436	No		
45	1,455	Yes	50	81,206
46	1,479	Yes		136,401
47	1,499	Yes		163,382
48	1,548	Yes	50	71,962
49	1,550	No		
50	1,603	Yes		236,806
51	1,678	No		
52	1,716	No		
53	1,994	Yes	50	166,340
54	2,087	Yes		121,489
55	2,112	No		
56	2,141	No		
57	2,204	No		
58	2,206	Yes		104,081
59	2,558	Yes	50	110,545
60	2,686	Yes	50	2,810
61	2,692	No		0
62	2,833	No		
63	2,934	Yes	50	201,455
64	3,191	No		0
65	3,543	No		
66	3,653	No		
67	3,659	Yes	50	170,310
68	3,845	Yes	50	236,296
69	3,869	Yes	50	586,756
70	4,069	No		
71	4,090	No		
72	4,383	Yes	50	386,532
73	4,774	No		
74	4,784	Yes		436,135
75	5,051	Yes	50	512,666
76	5,417	Yes	50	194,260
77	5,884	Yes		655,079
78	6,498	No		
79	10,547	Yes		803,364
80	12,378	No		
81	13,289	No		
82	27,183	No		

[1] Not available.

NOTE.—The write down of the book value of real estate comprises the difference between the book value of the real estate and the new appraisal. This loss figure is designated as "losses" in the records and is exclusive of anticipated losses.

NOTE.—The above tabulation includes three institution not included in addendum B and for which complete loss data are not available.

Source: Records from the files of the Savings and Loan Department, State of Wisconsin.

ADDENDUM C.—*Depression experience of Milwaukee savings and loan associations: Reserves and losses (institutions listed according to percentage of loss)*

Association	Assets Dec. 31, 1930 (thousands)	Percentage surplus and reserves to net mortgage balance	Net debits to loss reserves 1935–1939–40	Net loss on real estate owned at end of 1939 or 1940	Total loss	Total loss as percentage of yearend 1930 net mortgage loan balance
1 [1]	$1,603	4.4	$343,663	$236,806	$580,469	55.1
2 [1]	1,406	1.9	94,840	252,637	347,477	36.1
3	1,334	2.4	146,466	161,760	308,226	33.1
4	789	1.2	85,280	99,120	184,400	31.7
5 [1]	1,407	2.6	54,976	252,363	307,539	31.5
6	794	1.4	64,947	102,480	167,427	30.3
7 [1]	539	2.5	27,132	80,935	108,067	30.1
8 [1]	3,869	4.5	157,793	586,756	744,549	29.4
9	71	2.1	3,634	10,080	13,714	29.2
10	107	9.9	2,240	18,240	20,480	28.8
11 [1]	1,273	2.1	68,922	179,336	248,258	27.8
12 [1]	1,479	1.3	142,644	136,401	279,045	27.3
13	365	2.1	28,744	33,600	62,344	26.3
14	2,204	2.1	204,892	196,800	401,692	26.1
15	1,276	1.9	110,466	125,520	235,986	25.5
16	354	1.1	5,265	61,200	66,465	25.2
17	2,141	2.3	206,337	175,920	382,257	25.0
18	353	1.6	28,668	33,360	62,028	24.3
19	356	1.6	30,367	29,520	59,887	23.9
20	379	1.2	26,365	33,360	59,725	23.8
21	12,378	3.0	355,758	1,724,640	2,080,398	23.7
22	4,089	2.4	263,538	411,600	675,138	23.3
23	1,678	3.4	96,585	168,480	265,065	21.7
24	1,171	2.5	82,738	88,800	171,538	21.4
25	419	1.2	34 549	19,920	54,469	21.4
26	1,330	3.1	88,349	111,840	200,189	21.1
27	771	1.5	41,777	67,440	109,217	20.9
28	789	3.0	36,809	80,880	117,689	20.5
29	27,183	5.8	763,962	3,170,640	3,934,602	20.0
30 [1]	1,054	2.3	36,791	139,680	176,471	20.0
31	660	2.3	34,490	49,920	84,410	19.6
32	1,019	5.3	15,285	128,640	143,925	19.4
33	294	1.0	23,303	14,880	38,183	19.4
34	320	1.8	16,460	26,880	43,340	19.3
35	1,168	8.2	108,438	54,000	162,438	19.2
36 [1]	1,499	4.1	45,241	163,382	208,623	19.2
37	2,692	3.4	125,204	231,120	356,324	18.6
38 [1]	5,884	5.3	116,951	655,079	772,030	18.5
39	6,498	6.4	455,353	403,440	858,793	18.1
40	5,051	2.1	129,512	512,666	642,178	18.1
41	1,436	2.3	55,061	132,000	187,061	18.0
42	3,543	2.8	159,182	284,400	443,582	17.4
43	1,211	1.8	67,095	85,680	152,775	17.4
44 [1]	941	2.0	27,999	75,248	103,247	17.3
45 [1]	1,455	1.8	94,619	81,206	175,825	17.3
46	1,550	2.9	59,089	130,320	189,409	17.0
47 [1]	4,784	1.8	137,466	436,135	573,601	16.8
48	801	1.9	29,361	64,080	93,441	16.2
49	705	2.5	24,048	60,240	84,288	16.1
50 [1]	1,994	2.9	60,994	166,340	227,334	16.0
51 [1]	2,934	2.8	134,664	201,455	336,119	15.8
52 [1]	4,383	2.4	68,809	386,532	455,341	15.6
53 [1]	3,845	1.7	166,845	236,296	403,141	15.4
54 [1]	10,547	3.0	337,892	803,364	1,141,255	15.2
55	4,774	2.8	123,206	378,240	501,446	14.7
56	996	7.2	27,829	67,920	95,749	14.6
57	2,112	3.4	62,918	149,040	211,958	14.6
58 [1]	620	.9	27,586	35,759	63,345	14.1
59 [1]	3,191	3.8	125,162	186,240	311,402	14.0
60	13,289	4.4	138,860	1,188,000	1,326,860	13.8
61	1,202	4.0	9,992	109,200	119,192	13.5
62 [1]	857	1.7	33,238	47,849	81,087	13.4
63	360	1.2	31,427	....	31,427	13.0
64 [1]	926	1.9	30,476	49,153	79,629	12.3
65	2,833	4.3	53,708	195,360	249,068	12.2
66 [1]	2,087	2.3	64,094	121,489	185,583	12.0
67 [1]	2,558	2.1	99,582	110,545	210,127	11.7
68	4,090	3.5	46,500	297,120	343,620	11.6
69	3,653	2.1	86,776	216,960	303,736	11.6
70	931	3.1	21,481	36,880	78,361	11.4
71	797	1.9	10,176	50,880	61,056	11.4
72	1,716	2.1	29,545	103,680	133,225	10.6
73	2,686	2.7	176,303	2,810	179,113	9.6

See footnote at end of table.

ADDENDUM C.—*Depression experience of Milwaukee savings and loan associations: Reserves and losses (institutions listed according to percentage of loss)*—Continued

Association	Assets Dec. 31, 1930 (thousands)	Percentage surplus and reserves to net mortgage balance	Net debits to loss reserves 1935–1939–40	Net loss on real estate owned at end of 1939 or 1940	Total loss	Total loss as percentage of yearend 1930 net mortgage loan balance
74	$2,206	3.5	$51,048	$104,081	$155,129	9.5
75 [1]	1,548	2.4	26,480	71,962	98,442	9.2
76	5,417	2.3	156,811	194,260	351,071	8.9
77 [1]	503	1.1	21,875	8,636	30,511	8.5
78 [1]	3,659	3.3	42,167	170,310	212,477	8.2
79	338	.8	10,598		10,598	4.2

[1] Reorganized.

Source: Published reports and record from the files of the Savings and Loan Department, State of Wisconsin.

ADDENDUM D.—*Depression experience of 21 Kansas City savings and loan associations: Reserves and losses (institutions listed according to percentage of loss)*

Association	Assets, August 1930 (thousands)	Percentage surplus and reserves to mortgage balance	Total loss (net debits to loss reserves), 1935–43	Total loss as percentage of, August 1930 mortgage loan balance
1 [1]	$3,063	8.0	$1,030,565	51.1
2	100	3.8	36,555	42.0
3 [1]	376	3.2	107,808	29.7
4	3,124	24.0	722,373	28.1
5 [1]	8,377	9.8	1,766,045	23.8
6	2,865	4.8	488,948	18.0
7 [1]	219	14.5	26,221	14.3
8	704	5.3	74,678	12.8
9	2,629	3.2	265,633	11.4
10 [1]	1,550	.9	122,782	9.6
11 [1]	330	19.0	24,668	9.4
12	1,939	1.4	133,856	8.1
13 [1]	813	2.9	51,143	6.7
14 [1]	1,434	21.0	83,502	6.3
15 [1]	336	14.8	18,123	6.2
16	12	12.3	668	6.1
17 [1]	1,020	7.9	48,298	5.8
18 [1]	144	1.5	4,647	4.4
19	119	9.4	3,697	3.6
20	3,544	3.0	56,294	1.8
21 [1]	39	6.6	[2] –1,783	[2] 5.8

[1] Reorganized.
[2] Net gain.

Source: Missouri State Supervisor Reports.

E. Capital Gains and Losses

(Excerpt from "A Study of Saving in the United States," vol. II, pp. 264–267)

In the absence of firsthand data on the capital gains and losses of savings and loan associations, it is necessary to resort to indirect, and unfortunately very rough, estimates. Such estimates can be obtained in two ways, either from a comparison of retained operating income and surplus or from an estimate of the amount of real estate foreclosures and the losses on them.

Retained net operating income can be approximated with only a moderate margin of error since 1938, when the figures for associations reporting to the Federal Home Loan Bank Board become available. For the years before 1938, however, only very rough approximations can be obtained as it is necessary to apply assumed average rates of operating income, expenses, and dividends to the total assets of all operating associations. From these figures it appears

that operating associations in 1930–45 retained approximately $710 million out of their net operating income (see table J–9, col. 3). It may be assumed that associations in liquidation paid out their entire net operating income, if any.

The change in reported surplus of operating associations may be estimated, beginning with 1938 from the reports to the Federal Home Loan Bank Board and before 1938 on the basis of the reported figures for the associations in about half a dozen of the most important States, which account for about two-thirds of the total assets of all operating associations. These figures indicate (after allowing for the reduction which reflects the dropping out of the statistics of associations put into liquidation) an increase of about $110 million in reported surplus between the end of 1929 and the end of 1945, the sharp reduction in the first part of the period being not much more than compensated for by the increase in the 1940's.

For the surplus of the liquidating associations only a very rough estimate can be made. If it is assumed that the book value of the surplus of liquidating associations bore the same proportion to their total liabilities at the time they went into liquidation as prevailed for operating associations, and that the entire surplus disappeared, then the reduction would have amounted to $75 million.

In the case of liquidating associations, however, losses were not limited to the disappearance of the surplus but affected share capital and deposits as well. According to estimates of the U.S. Savings & Loan League, these losses amounted to $210 million for the period 1930–45. This figure is probably a minimum since it is based on estimates made at the time each association went into liquidation.

The total loss, estimated by a comparison of retained operating income and change in reported surplus thus amounts to approximately $600 million for operating associations and $290 million for closed associations, a total of nearly $900 million according to the first method of estimation.

A second method starts from the reduction in the book value of real estate holdings. According to the combined balance sheet of all operating associations, the reduction amounted to $1,130 million between the end of 1935 and the end of 1945 (see table J–2, col. 4). This figure, however, understates the total amount of real estate sold as additional properties were undoubtedly foreclosed during the period in which total real estate holdings declined, and as certain expenses like acquisition costs, operating deficits, and taxes were added to the book value of the real estate account. Actual sales probably were at least as high as $1,300 million for operating associations alone. There is little material on which to base an estimate for closed associations. It may be inferred, however, from the amount of their total assets and the probability that a higher proportion of their loans had to be foreclosed that their real estate sales were as high as $500 million.

The average loss ratio on the book value of real estate sold may be put at 25 percent, assuming that the Home Owners' Loan Corporation data which refer to residential real estate loans of all types of lenders are valid also for savings and loan associations. Application of this ratio to total estimated sales of real estate yields an estimate of total loss of about $325 million for all operating associations.

However, it is known that in many cases the book value of real estate held had been substantially reduced through writeoffs before final sale. No direct information on the size of such writeoffs is available. Resources must therefore be had to the relation between realized losses on real estate sales and previous writeoffs in the only case in which this is known; viz, the Massachusetts mutual savings banks. Applying that rate of about 75 percent, the writeoffs on real estate made by the operating associations before sale may be estimated at about $245 million. This would bring their total losses to about $570 million.

The rate of loss suffered by the closed associations in the course of their liquidation probably was higher than for operating associations, but if an arbitrary estimate of 40 percent is accepted, their losses amounted to about $200 million. This figure should be regarded as including writeoffs on real estate before sale.

Additional losses arose on the occasion of transferring a considerable amount of mortgage loans to the Home Owners' Loan Corporation in the aggregate acquired home mortgages at a discount of slightly less than 10 percent of their face value, a proportion which may be assumed to apply also to the mortgages tendered by savings and loan associations. The amount of mortgages acquired

from savings and loan associations may be estimated from Howe Owners' Loan Corporation records at about $950 million and the loss on the exchange may be put at about $80 million.

The total loss estimated by the second method thus amounts to about $650 million for operating associations and about $200 million for closed associations, a total of about $850 million.

A rough check on the reasonableness of this figure is possible through a comparison with the experience of Massachusetts savings banks. At $850 million the mortgage loan losses of savings and loan associations, both operating and closed, amounted to about 13 percent of their total mortgage portfolio of 1930.

The Massachusetts mutual savings banks show losses on their total mortgage portfolio of 1930 of nearly 15 percent. However, their loss experience was considerably more favorable with residential than with other mortgages. If it is assumed that the ratio of losses to loans outstanding in 1930 of these two types of mortgage loans bore the same relation as that of the ratio of losses to loans made, then the Massachusetts savings banks lost nearly 9 percent on the residential mortgages on their books at the end of 1930. This ratio is somewhat lower than that calculated above for all savings and loan associations, but it is quite close to that for operating associations, which may be estimated at around 10 percent (losses, $650 million; mortgages outstanding in 1930, $6,400 million).

Thus, there are two estimates, both very rough, of the net capital losses of savings and loan associations in the period 1939–45 (see table J–10). The first approach, based essentially on the income account, yields estimates of about $600 million for operating and $200 million for closed associations, a total of nearly $900 million. The second estimate is only about 5 percent lower, partly because the direction of the discrepancy is different for operating and for closed associations. The estimates for operating associations alone differ by less than $50 million, or 8 percent. The discrepancy is larger both in absolute and in relative terms, for the closed associations, a field in which most figures must remain largely guesswork.

In view of the extremely rough character of both approaches, it is difficult to choose between the two estimates on substantive grounds. (It is possible, of course, that an improvement of the figures would reduce or increase the difference.) The first estimate has the advantage of being built up from a set of annual figures while the second does not easily permit a division of the total loss estimate into annual figures. For this reason preference has been given to the first (income account) approach in the estimates used here.

(Copied from hearings before the Committee on Ways and Means, House of Representatives, 87th Cong., 1st sess., on "Treasury Department Report on Taxation of Mutual Savings Banks and Savings and Loan Associations," Aug. 9 and 10, 1961, pp. 339–340.)

FEDERAL HOME LOAN BANK BOARD,
DIVISION OF SUPERVISION,
August 10, 1961.

To: Chairman McMurray.
From: John M. Wyman.
Subject: Reserves of savings and loan associations.

In further reference to the subject matter, it is clear that there is no historical support whatever for the thesis that the reserves of insured savings and loan associations ever have been or that they now are required by the Board for bad debt purposes only, as I understand the meaning of that term: Indeed, the economic facts of the matter make such a thesis untenable.

Both the genesis and the objective of the Board's requirement that insured associations build up their reserves to an amount equal to the percentages from time to time prescribed by the Board's regulations to be found in this public necessity, namely: Establishment of a cushion sufficient in relation to savings capital to absorb losses of all kinds and to assure the stability and safety essential to serving adequately the country's long-term home financing needs, which was the end purpose for which Congress provided for the chartering and for insurance of these institutions.

The first regulatory requirement with respect to this matter was made by the Board in 1933. That regulation required reserves to be built up to an amount equal to at least 5 percent of savings capital; and that such reserve be maintained for the purpose of absorbing any losses incurred.

At the time that requirement was made, savings and loan associations owned approximately $828 million of real estate which had been acquired by foreclosure of loans, an amount equal to about 11.8 percent of the assets of the associations at that date. By the end of 1934 such real estate owned had increased to a little over $1 billion; and by the end of the 1935 it had increased to almost $1.2 billion, or 27.3 percent of assets.

In late 1936 the Board developed a revised form of charter for Federal savings and loan associations. In view of the tremendous increases in the amount and percentage of real estate owned by savings and loan associations, the Board increased the reserve requirement from 5 to 10 percent of savings accounts. This revised form of charter also provided that any loss may be charged against the reserves.

In 1934 Congress included in section 403(b) of the National Housing Act a requirement that each institution insured by the Federal Savings and Loan Insurance Corporation must build up its reserves in accordance with regulations made by the Corporation but made it mandatory that such regulations require the building up of reserves to an amount equal to 5 percent of all insured accounts within a reasonable period not to exceed 10 years (later changed to 20 years) and, further, that such regulation prohibit the payment of any dividends, without approval by the Corporation, if any losses are chargeable to such reserves.

Two things appear to be made unmistabably clear by the foregoing facts:

(1) The concept of reserves by the Board and by Congress was that they were to provide a cushion or fund from which any losses—not just bad debt losses—may be absorbed.

(2) Both the Board and Congress, from the very beginning, recognized a relationship between reserves and savings capital; and, while providing a fund from which to absorb losses, were also motivated by important considerations of operating stability.

Unfortunately, there are no statistics covering the loss experience of savings and loan associations resulting from loan foreclosures which began to assume sizable proportions in 1930 and which did not reach the peak until 1935–36. It is, of course, common knowledge that in the 1930's hundreds of savings and loan associations were reorganized by writing down capital or by segregation of real estate and distressed loans prior to application for conversion to a Federal charter or for insurance of accounts. Many of these reorganizations took place prior to such applications, and consequently we do not know their loss experience. In this connection, we do have complete or partially complete information as to 177 associations which segregated on a basis that conveyed to liquiding corporations or trusts the interest of the holders of savings accounts ranging from 10 to 80 percent of the institution's savings capital.

Of that 177 associations, the segregated savings capital aggregated approximately $100 million Such savings had been invested by the associations in loans which for the most part were originally made subject to a limitation of 66 to 75 percent of the appraised value of the security real estate and for terms of not more than 15 years The average experience of the liquidating corporations or trusts as to which we have complete data was that losses suffered in liquidating the segregated assets consumed 81 percent of the segregated savings capital, above all recoveries and earnings This figure does not include the substantial loss of earnings to the owners of such savings during the several years required to complete liquidation and during which they received no dividends or interest.

The economic fallacy of dealing with this matter on a short-term basis or on the basis of so-called nonrisk assets is forcefully illustrated by the following facts:

(1) At the close of World War II, insured savings and loan associations held cash and Government obligations equal to 41 percent of the total savings invested in such associations; by the end of 1946 that percentage had dropped to 30; by the end of 1947, to 23.7; and by 1948, to 19.6. The explanation is, of course, a simple one: As quickly as possible after the close of the war cash and Government obligations were converted into long-term mortgage loans to meet the pent-up demand for homes. To establish a reserve requirement or permit so associations would be unable to build reserves again a comparable conversion of so-called nonrisk assets into long-term mortgage loans could be jeopardous indeed of the interests of the associations and of the public to which such associations must look for the savings with which to do the home financing job required.

(2) With respect to the proposition that losses realized by savings and loan associations are usually concentrated in a relatively short period of time, the fact is that it was not until December 31, 1942, that foreclosed real estate owned by savings and loan associations was reduced to a lesser amount than the $238 million balance held at December 31, 1930—a period of 12 years—and that despite the fact that HOLC, within that period of time, relieved savings and loan associations of many hundreds of millions of dollars of distressed loans.

JOHN M. WYMAN.

(Copied from hearings before the Committee on Ways and Means, House of Representatives 87th Cong., 1st sess., on "Treasury Department Report on Taxation of Mutual Savings Banks and Savings and Loan Associations," Aug. 9 and 10, 1961, pgs. 35-37.)

A STUDY OF DEPRESSION LOSSES BY SAVINGS AND LOAN ASSOCIATIONS IN CALIFORNIA

(By Milton O. Shaw, Nov. 30, 1959)

At the close of the year 1930 there were 210 State savings and loan associations in operation in California. Ten years later there were but 100 of these associations in operation. In this same period the loans in force dropped from $415 million in 1930 to $133 million in 1940.

In the case of six associations no reports could be found. This study, therefore, includes the remaining 204 California associations.

All of the material in this study was obtained from the annual reports filed by California associations with the savings and loan commissioner, from the published reports of the commissioner and from data accumulated by this writer during his 28 years as an employee of the division of savings and loan. The annual report filed by each association with the commissioner is, by law, made a pubic document and is open for inspection by the public.

REVIEW OF ACCOUNTING METHODS

In California, associations were not permitted to capitalize interest to date of foreclosure into the book value of real estate. Under such a procedure, the longer the association delayed in foreclosing, the greater the profit it would show on the books and the real estate account would be that much higher. The loss on a sale is a more accurate figure where interest is not added to book value.

Also, in California, associations were required to show rentals received on foreclosed properties in an income account and profits from sales in another income account. Similarly, expense on real estate and losses on sales were shown in separate expense accounts. Further, associations were required to take regular depreciation on the improvements in the foreclosed real estate account.

In this report the income from foreclosed real estate as well as real estate expenses and depreciation have been included with the profits and losses from sales in order to arrive at a net profit or loss for each association. Also, any rdeuction of loss reserve has been taken into account. If at the end of the year 1940 the association had real estate on the books and no reserve for loss, a 3-percent deduction for estimated loss has been taken into account. This is believed to be a very conservative estimate. In addition, any profits or losses from sales of loans and of exchanges of loans for Home Owners' Loan Corporation bonds have been taken into account in this report.

LOSS EXPERIENCE

The net losses of the 204 California State associations from their loan and real estate operations amounted to $53,608,047 in the 10-year period under study. This represents an average loss of 12.917 percent of the $414,995,154 loans in force at the beginning of the period.

The reserves of these 204 associations averaged 2.65 percent of the 1930 loans in force. In addition, the guarantee stock averaged 4.69 percent of the 1930 loans in force.

The table which follows summarizes the depression losses as to various percentages of loss:

Percentage of loss to 1930 net loans in force	Savings and loan associations		Asset distribution	
	Number	Percentage of total	1930 assets (000 omitted)	Percentage of total
Less than 5 percent	129	63.2	$172,119	36.9
5 percent and less than 10 percent	25	12.3	71,763	15.4
10 percent and less than 15 percent	14	6.9	47,418	10.1
15 percent and less than 20 percent	9	4.4	15,020	3.1
20 percent and over	27	13.2	161,177	34.5
Total	204	100.0	467,504	100.0

A further analysis of the losses shows that the greatest losses by individual associations occurred in the four largest California cities. The least losses were found in the small outlying communities.

MARKET FOR SAVINGS ACCOUNTS

In addition to the losses by associations themselves there were other substantial losses by savings account holders.

During the period from 1930 to 1937 nearly all California associations were requiring notice for withdrawal of savings. In many cases withdrawal requests remained unpaid for several years. As a result of this condition an unlisted market for savings accounts was very active. Brokerage houses regularly published "bid" and "asked" quotations for savings accounts. A photocopy of one of these lists, dated August 1, 1935, containing quotations on 75 California associations is attached hereto, marked "Exhibit A." Similar lists appeared in the daily newspapers. The going price for savings accounts averaged around 50 cents on the dollar.

Many associations built up a big business of selling foreclosed property in exchange for their own savings accounts. Knowing that such purchasers were using about a 50-cent dollar, many managers increased the sales prices of real estate, and thus many expected losses were turned into profits. Millions of dollars of such transactions took place in California. Such losses to savers have not been accounted for in this report, except in a few instances where exact figures were obtained.

CONVERSION FROM STATE TO FEDERAL

The losses reported herein are understated due to another factor. In the 10-year period under study there were 45 State associations which converted into Federal associations. There were 31 of these which converted in the years 1935 and 1936. On none of the 45 associations do we have a full 10-year operation record. Several of these associations converted on a segregated basis, i.e., part of the assets such as real estate and delinquent loans were placed in liquidating corporations. There undoubtedly were losses after conversion, particularly in the liquidating corporations. Inquiry at the Federal Home Loan Bank of San Francisco developed the fact that no records are now available as to what happened in these Federal associations during the years under study.

LIQUIDATIONS

During the 10-year period under study there were 29 California associations which were liquidated by the Division of Savings and Loan, and three were liquidated by Federal receivers. The losses in those 32 liquidations are included in the figures of this report. As in the case of other associations, there were losses by savers in the associations which were liquidated which cannot be accurately measured and are not included in this report. This refers to those whose savings were frozen for many years in these liquidating associations and who were forced to sacrifice their claims against liquidating associations on the unlisted market. The total assets of these associations at the beginning

of liquidation amounted to $58,800,000. The California law authorized the Commissioner to estimate the value of claims in the liquidating associations and to fix the value at which claims would be accepted on sales of real estate. This value was always well under the ultimate recovery estimate. But this practice did provide a market for those who had to have money, and a greater loss would have resulted in each liquidation except for the cheap dollar used to purchase much of the real estate.

GREATER RESERVES REQUIRED

Approximately 85 percent of savings and loan association assets consist of loans on real estate. These loans are now written for terms of from 15 to 25 years. The real estate cycle has its ups and downs in long-term swings, ordinarily 15 to 20 years between the high and the low points. Therefore, savings and loan associations require greater bad-debt resreves than do banks, whose loans in most cases run for 1 year or less.

In the next depression period the losses by savings and loan associations can be expected to be larger than those shown in this report. Some of the responsibilitity for this situation must be laid at the door of the Home Loan Bank Board, in Washington, D.C. In recent years said Board has encouraged higher percentage loans and longer term loans by taking the following actions:

(1) Authorized 25-year loans on real estate. (The average loan made by California associations during the period of this study was 11 years.)

(2) Authorized Federal associations to make loans equal to 90 percent of the value of real estate. (During the period covered by this study, California associations were permitted to make loans only on single-family dwellings of up to 80 percent of the value of the property, otherwise only up to 70 percent of the value.)

(3) Authorized Federal associations to make unsecured loans in amounts of not more than $3,500 each. (California associations have never been permitted to make unsecured loans.)

State associations in some States have already been permitted to meet the terms of loans being made by Federal associations. In other States, including California, the pressure is on to permit State associations to make higher percentage and longer term loans.

It would seem that inasmuch as property is now selling for prices which are four or five times higher than the same property sold for during the period covered by this study, there is much more room for greater losses to occur in the next depression.

MILTON O. SHAW.

(Copied from hearings before the Ways and Means Committee, House of Representatives, 87th Cong., 1st sess., on "Treasury Department Report on Taxation of Mutual Savings Banks and Savings and Loan Associations," Aug. 9 and 10, 1961, pp. 350–352.)

The CHAIRMAN. Senator Long?

Senator LONG. What percentage of your mortgages are insured?

Mr. BUBB. About 15 percent, Senator.

Senator LONG. About 15 percent?

Mr. BUBB. Yes, sir.

Senator LONG. If you were not organized as a savings and loan, but simply an individual or a private corporation making loans and collecting interest, when a loan had been made and then paid off, you would pay your income tax at the time that the loan was repaid with interest; would you not?

Mr. BUBB. Well, of course, if you are a private individual doing business as a private individual you would pay your income tax on the income as it is received; yes, that is correct.

In other words, there is no law such as the act of 1951 to allow a private individual to set up reserves for future losses on real estate mortgages.

Senator LONG. Yes.

Thanks very much.

Mr. BUBB. Yes, sir.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. I will try to be brief.

The testimony coming in from all of the witnesses, both sides of whatever controversy exists on the many sections of this bill, have been helpful.

This is one bit of information that I need. What is a stock savings and loan association and how does it operate?

Mr. BUBB. A stock savings and loan association, Senator Curtis, operates basically like a mutual savings and loan. They both make the same type of loans. We both take in savings from the people and we loan it out on mortgage loans and they have the same chance of risk that we have.

Senator CURTIS. Now, who owns a mutual savings and loan?

Mr. BUBB. The shareholders own a mutual savings and loan.

Senator CURTIS. Who are the shareholders, the borrowers or the savers.

Mr. BUBB. The shareholders are the savers.

Senator CURTIS. The savers.

If the company would be liquidated it was they——

Mr. BUBB. That is correct, sir.

Senator CURTIS. Who own a stock saving and loan association?

Mr. BUBB. The stockholders would own a stock savings and loan; that is the only difference. Their stock is put up as additional reserves over and above reserves built out of earnings.

Senator CURTIS. Are dividends paid to them?

Mr. BUBB. Well, some do and some don't.

Senator CURTIS. There has been quite a growth of stock savings and loans since—that is stock in the sense that is used—since the 1951 act; is that correct?

Mr. BUBB. You mean in comparison with the growth of Federals or do you mean there are more stock savings and loans?

Senator CURTIS. I don't mean the number. There are a number of companies which have been formed.

Mr. BUBB. Yes; that is correct, sir.

Senator CURTIS. Now, are they formed for the purpose of properly managing a mutual or effectively or efficiently managing a mutual operation or are they being formed for profit by the stockholders?

Mr. BUBB. Well, let me just put it this way: I happen to run a mutual, but I see nothing wrong with a stock savings and loan because it is the American way of doing business.

Senator CURTIS. I am not passing judgment on anybody's business that they operate.

In order to get the full picture, when we have to come to a conclusion here in these tax matters, I am trying to find out how they operate.

Mr. BUBB. Yes, it is true. They operate the same as the mutual except if there is a liquidation, of course, the reserves that are left over after liquidation would go to the stockholders.

Senator CURTIS. Well now, does Kansas have stock savings and loans?

Mr. BUBB. Yes, they do.

Senator CURTIS. Roughly, what portion of your savings and loans are stock?

Mr. BUBB. I would say the majority of the number are stock, but not the majority of the assets.

Senator CURTIS. In Kansas, the majority. Those were created prior to 1951?

Mr. BUBB. That is correct.

Senator CURTIS. I am talking about the stock companies that have come into being since the 1951 act. Have there been very many of those in Kansas?

Mr. BUBB. No, sir.

Senator CURTIS. Where have they been located?

Mr. BUBB. Well, I presume that most of them have been in California.

Senator CURTIS. Do you know how they operate?

Mr. BUBB. Well, you mean—if you don't mind, define what you mean. What do you mean by how they operate?

Senator CURTIS. I want to know if they are run for the benefit of the owners, that is, the stockholders, contrary to the mutual arrangement of the ordinary savings and loan.

Mr. BUBB. No, sir. I would say if they were they would not be successful. They have got to be run for the benefit of the community or they would not be successful. It is true that the owners may make a profit out of them.

Senator CURTIS. Are any figures available as to what extent they have been profitable for the stockholders operating under a definition and under an actual law set up for a mutual operation?

Mr. BUBB. I do not know of any figures, Senator, unless the Federal Home Loan Bank has compiled some recently. They are all insured, of course.

Senator CURTIS. In detailing further my question in the allocation of earnings—whether it shall be dividends to savers which, after all, is interest, or to owners of a company—who makes those decisions?

Mr. BUBB. Well, the board of directors of the association.

Senator CURTIS. The board of directors?

Mr. BUBB. Yes, sir.

Senator CURTIS. By whom are they elected?

Mr. BUBB. Well, they are elected by the stockholders of a stock association in some States. Some States require that the shareholders elect so many directors. A number of States differ on that.

Senator CURTIS. A number of States do not have stock associations.

Mr. BUBB. That is correct.

Senator CURTIS. Is there anyone on this panel who can give us enlightenment on the operation of stock savings and loans?

Mr. MCKENNA. Senator, I think we should recognize first there are varying lines of distinction between the mutual and stock. The lines are not definite, and there are stock associations in which the stockholders have no more rights than the ordinary savings account holder, and in most stock associations not only the savings account holders but also the borrowers participate in the selection of management and directors.

Senator CURTIS. Are you making any distinction between the new stock companies and those that existed prior to 1951?

Mr. McKENNA. Well, there may be a distinction in percentages. The laws are the same. So in order to comply with the definition of the Internal Revenue Code, all of them allow the borrowers to participate in the selection of management.

I might point out, however, that before there can be any distribution of dividends to a stockholder of these associations, a full corporate tax must be paid. Nothing can be taken out of reserves. The taxes have to be paid out of, in order to put it in undivided profits from which it can be distributed to a stockholder.

Senator CURTIS. I realize we are using some labels that may be a bit confusing because the savings and loan association of many years ago always sold a stock membership to their members, did they not, and sold a membership fee, and they became stockholders and that is not followed.

Mr. McKENNA. In many States it was stock, usually it was shares. Ownership, of course, has normally been——

Senator CURTIS. The same as buying a membership.

Mr. McKENNA. Yes.

Senator CURTIS. That is not generally followed any more?

Mr. McKENNA. It is followed but in a different way, Senator. This, of course, gets back to our problem with the definition is tied to an operation of 50 years ago. The operations which the Government wants us to conduct now are different.

Senator CURTIS. My information is that due to peculiar language in the 1951 act that there has been quite an increase, particularly in California, of stock savings and loans.

Is it true that some of the mutual savings and loans have been worried about the activities of the stock companies, particularly in California?

Mr. BUBB. Well, I suppose every savings and loan is worried about its competitor, as in every other business. If we discuss the merits of the worry then, perhaps, we can talk about more concrete concepts.

Senator CURTIS. I am not getting very much information.

Mr. BUBB. I would like to answer your questions, Senator, if I can understand them a little more specifically.

I think basically we can say this: No profits can be taken out of a stock association for the stockholders without the payment of a normal corporate income tax.

Senator CURTIS. I understand that.

Mr. BUBB. Now they compete with mutual associations. If there are risks in their lending operations, those risks should be substantially the same as those of mutuals, and presumably they need the same reserve allocations.

Senator CURTIS. Well, how many stock savings and loans have been created since 1951?

Mr. BUBB. I do not have the number.

Senator CURTIS. And what size are they?

Mr. BUBB. I cannot answer. We do not have those statistics, sir.

Mr. STRUNK. I would say, Senator Curtis, that most of the existing stock type savings and loan associations predate 1951.

Senator CURTIS. I am talking about those since 1951.

Mr. STRUNK. I see. So it is a minority of the stock type institutions.

Senator CURTIS. Are there some large ones among them?

Mr. STRUNK. Large new stock companies?
Senator CURTIS. By new I mean since 1951.
Mr. STRUNK. Yes.
Mr. MCKENNA. Inevitably there would be some. I do not know.
Mr. STRUNK. I will say most of the large stock companies predate, were organized prior to, 1951.

Frankly, in our records we do not have the organization date and all of this, so we are working strictly from memory here on this point.

Senator CURTIS. I may be pursuing a blind alley where there is no information available, but I would like to know to what extent the tax law, either one now or what may be written here, in general applying to a mutual operation, where all the assets, including many of these fine and new buildings that were built, and so on, belong to the savers and to what extent, operating under that same tax law, there is a stock company where these assets and, at least some of the profits, are not the property of the savers.

I would like to know to what extent that is a part of the industry. It might be totally insignificant, I do not know.

Mr. STRUNK. The total assets of the stock-type savings and loan associations are about 12 percent of the total.

Senator CURTIS. About 12 percent?
Mr. STRUNK. Yes.
Senator CURTIS. How do you define the assets of a savings and loan?
Mr. STRUNK. Cash and mortgage loans, and office building and total assets.

Senator CURTIS. Total assets, not total assets less the demands of savers?

Mr. STRUNK. No, sir. No, the left-hand side of the balance sheet is what I am talking about and of the total assets of the savings and loan business, roughly $80 billion currently, I say 12 percent of that is probably represented by stock-type institutions.

Senator CURTIS. What kind of business organizations operate these concerns that will take a sizable amount of money and serve as the agents for the depositors in placing it in many savings and loan associations?

Mr. BUBB. Those are brokers, Senator, and the Federal Home Loan Bank has passed a regulation recently saying that savings and loan associations cannot have over 5 percent of their savings in money generated by these brokers.

Senator CURTIS. Now, are they just an ordinary broker or do they——

Mr. BUBB. Just an ordinary stockbroker; yes, sir. Frankly, they are a nuisance in my personal opinion.

Senator CURTIS. Understand I am not passing judgment on any of these, but I am in the dark as to how some of these things operate. You see an advertisement—or, first, let me ask, what is the maximum amount of insured savings that one individual can have in one institution?

Mr. BUBB. $10,000 per account.

Senator CURTIS. Per account. Now and then you will see advertisements in financial journals or otherwise where someone will accept for savings and loan accounts so much greater than that, $100,000 or more, and they will do the placing. How is that done?

Mr. STRUNK. Senator Curtis, this is a fairly specialized phase of the securities business. These people operate essentially in New York and, to my knowledge, they are all legitimate operations. I think they are members of the National Association of Security Dealers, and so forth, but they make it a business of seeking money for investment in savings and loan associations.

Each, as you say, each account in an insured institution is limited for insurance to $10,000, and somebody wants to invest $300,000, wants to have it all insured, he has got to spread that into 30 institutions, you see, and for a commission paid by the savings and loan association.

Senator CURTIS. Paid by the savings and loan association?

Mr. STRUNK. Paid by the savings and loan association, I think generally 1 percent. This broker will distribute this man's money into 30 institutions.

Senator CURTIS. Now, if the savings and loan association pays the commission, and it is a nuisance, it seems peculiar.

Mr. STRUNK. Senator, this is a nuisance to the institutions who do not like this kind of business. Some of them do.

Senator CURTIS. I see, but it is a nuisance if you do not want to pay the 1 percent.

Mr. STRUNK. Yes. [Laughter.]

Now, to go on a bit, the Federal Home Loan Bank Board felt a few years ago that some institutions were getting an unduly large percentage of their total savings from this source, and so the Board passed a regulation which says—which provided—that a savings and loan association cannot receive any more money in this manner if the total that it has exceeds 5 percent of its total savings.

So as a result of that regulation the brokerage business essentially began to disappear for a while.

Senator CURTIS. I am sorry that it takes so much time. I will ask your counsel just one more question. Is there anything new in the House bill in the way of definition or otherwise relating to stock savings and loan associations?

Mr. MCKENNA. Yes, there is, Senator.

Senator CURTIS. What does it do?

Mr. MCKENNA. It does basically two things: first, it locks in all of the profits which these associations have on which they have not paid taxes.

Senator CURTIS. It locks them in where?

Mr. MCKENNA. It locks them in so that they are the last of the surplus on which these associations can draw. They must draw out their reserves, pay their taxes on that first, before they can get down to these pre-1951 accumulations of undivided profits, the only undivided profits on which they have paid no taxes.

Senator CURTIS. Whose undivided profits are they, the savers' or the owners'?

Mr. MCKENNA. It would depend on the corporate structure of the corporation. We would assume the type of organization, and I assume that is what you mean, the type of stock organization in which they would belong to the stockholders.

Senator CURTIS. By locking it in, is that to the advantage of the savers or to the stockholders?

Mr. McKENNA. I would say it is basically to the advantage of the Government because it would mean that in order to get any money out of those associations, except out of current income or aftertax money, that a tax would have to be paid. That is basically designed, this provision, I would think——

Senator CURTIS. By locking it they cannot distribute it.

Mr. McKENNA. They cannot distribute it. As a practical matter, they cannot distribute it at all. As a theoretical matter they can only do it after they got rid of all of their resrves and paid all their taxes on their reserves.

Senator CURTIS. Now, how many savings and loan associations are there in the United States?

Mr. BUBB. 6,200, Senator.

Senator CURTIS. I realize my definition is going to be somewhat loose and vague. How many of them are local savings and loan associations with substantially all of the money of the savers are located in that community and substantially all of their loans are made in that community?

Mr. STRUNK. May I hazard a guess on this, and it would be strictly a guess? I would say of the 6,200 institutions, that 5,700 conform to this broad concept that you are talking about. There are—the larger institutions, many of them, do receive money from brokers, you see, and this would be a large institution in the Midwest

Senator CURTIS. And many of them reach out beyond State lines?

Mr. STRUNK. That is right. More and more of them are advertising in the national magazines, and the Wall Street Journal to get out. I would imagine that some of them do require mortgages. Sometimes they may buy a FHA loan or they may buy participations in loans. But whatever you mean by substantially, I would say that——

Senator CURTIS. I think I know of a few which maybe exist in a county seat; substantially all of their savers reside in that county, and the only mortgage market that they seek is the one in that particular locality. You say about 5,000 or 6,000 of them are that way?

Mr STRUNK. I would say about 80 percent, maybe 70 prcent—80 percent, I believe, at least, conform to this——

Senator CURTIS. What did you say the total assets of all savings and loans were?

Mr. BUBB. $80 billion.

Senator CURTIS. $80 billion total assets.

Now, this 80 percent, the small ones, how much of the assets do they own?

Mr. STRUNK. I do not know The small ones, by your definition of a "county seat town," this means a small institution, but many larger institutions do not reach out beyond their communities for savings.

Senator CURTIS. Well, I mean savings as well as mortgages.

Mr. STRUNK. Savings as well as mortgages.

Mr. BUBB. Senator, let me point out that a savings and loan association cannot reach out over 50 miles for mortgages unless they were doing it prior to 1934 when this act came into effect, and at that time they filed on that area with the Federal Home Loan Bank.

Now, it is true that they can reach out for savings anywhere, but they cannot reach out for mortgages out of the area in which the bank approves them to do business in.

Senator CURTIS. Can a savings and loan in Illinois loan money in California?

Mr. BUBB. No, sir. He can buy a participation under the present law in a loan that is made by an association in California.

Senator CURTIS. What is the difference?

Mr. BUBB. But he cannot go out there and make the loan or originate it.

Senator CURTIS. Well, he can invest in a mortgage.

Mr. BUBB. He can buy a participation in it now under a recent ruling by the Federal Home Loan Bank.

Senator CURTIS. And he can do that without having served in that territory prior to 1934 and without any special permission?

Mr. BUBB. That is correct. That regulation was passed so that you could put money from stagnant areas into growing areas.

Senator CURTIS. Please understand that I am not trying to harass any witness.

You made the reference to the small savings and loan, and I am thinking of some of those that, especially if the withholding tax goes in, they do all of these things manually, and I would like to know of the $80 billion assets of the savings and loan industry. What is the best guess as to how much of that is owned by the local savings and loan, substantially all of its savers living in that community, substantially all of the mortgages, and including participation, because that is sending money out. I am not quarreling with your function.

Mr. BUBB. Let us check out factbook here and see if we cannot give you something on it.

Senator CURTIS. Give me the best guess you have got, and I won't take any more time, and if you have to modify it, all right.

Mr. STRUNK. Of the total assets, I would say it looks like 30 percent of the total assets are held by institutions over $50 million in size, so 70—if I am adding quickly, correctly—70 percent are represented by institutions under $50 million in size.

Now, $50 million is still a fairly large institution.

Senator CURTIS. Have you got another breakdown?

Mr. STRUNK. Yes. Of the institutions under $10 million, 20 percent of the total assets, and 51 percent of the number—no, wait a minute, 70 percent of the number.

Senator CURTIS. Of the savings and loans whose assets are less, are $10 million or less?

Mr. STRUNK. $10 million.

Senator CURTIS. Do they constitute only 20 percent of the total assets?

Mr. STRUNK. Right.

Senator BENNETT. But 70 percent of the number.

Senator CURTIS. But 70 percent of the number of associations.

Mr. STRUNK. Of the total, 71 percent are institutions.

Senator CURTIS. Have $10 million or less assets?

Mr. STRUNK. That is correct.

Senator CURTIS. And they have 10 percent of the total assets?

Mr. STRUNK. Twenty percent of the total assets.

Senator CURTIS. Twenty percent of the total assets.

Mr. STRUNK. This is as of the end of 1960, Senator.

Senator CURTIS. I understand.

What I wanted to get was a general idea of what kind of institutions you were talking about. That is all.

The CHAIRMAN. Senator Douglas has one more question. Senator Gore?

Senator GORE. With respect to the percentage of losses, I have seen statistics which indicate that the loss in the decade 1951–60 was approximately one-hundredth of 1 percent. What are your statistics?

Mr. BUBB. I do not think we have any statistics of anything like that, Senator; but, of course, as I explained a minute ago, in that decade there are bound not to have been any losses on account of the inflation and shortage of houses.

Senator GORE. I understand that, but I thought since this had been discussed a good deal that we should show that the data the Treasury Department has for 1951–60 indicate that the bad-debt losses of the mutual savings banks averaged less than one-hundredth of 1 percent.

Mr. BUBB. That is of the mutual savings banks. I do not think we have any figures for the savings and loan associations.

Senator GORE. Do you have any figures for the savings and loan associations?

Mr. BUBB. No, sir. The Federal Home Loan Bank Board probably would have, but it would be small for that decade.

Senator GORE. Do you seriously contend that many times that amount as a bad-debt reserve is a fair and reasonable set-aside to be free of taxes?

Mr. BUBB. Well, the only thing we can base that on, Senator, is the amount of reserves needed in the past depression, and the amount of reserves that we think we are going to need for cyclical losses and, as I pointed out in my testimony, we took tremendous losses in the last depression on making, 10-, 11-, and 12-year loans on 65 percent of the value of the property.

Now the trend is to 80, 90 percent loans, 25 to 30 years, and I think either the FHA or the VA would tell you now that a great amount of foreclosures they are having are coming from the people who have a small amount of money in the property.

They are perfectly willing to walk off and leave it where the person who has a larger amount of money invested in the property is not.

Then when you take that property back now you are taking it back on a falling market. Many States you have to write out a redemption period——

Senator GORE. You think there is a falling market now?

Mr. BUBB. There certainly is in real estate at the present time; yes, sir. I am not trying to forecast the future, but in a business like the savings and loan business that makes long-term loans, it needs reserves for cyclical losses.

Senator GORE. You mentioned the FHA. Do you realize that the FHA has such a reserve?

Mr. BUBB. Yes, sir; and they need it.

Senator GORE. Do you know what size it is?

Mr. BUBB. No, sir; I do not.

Senator GORE. Do you know what percentage it is based upon?

Mr. BUBB. Well, of course, they charge one-half of 1 percent of the mortgage to set that reserve up.

Senator GORE. For your information the FHA reserve is based upon an assumption that a depression will begin tomorrow, and the estimated reserve requirements amount to 2.7 percent.

Mr. BUBB. It is not enough.

Senator GORE. You do not think it is?

Mr. BUBB. I do not think their reserves are enough; no, sir.

Senator GORE. Well, the reserves have certainly been adequate up to now.

Mr. BUBB. Yes, but they are just starting to take their losses. I do not know how long this is going to run. Let us hope that it is not going to run very long.

Mr. STRUNK. I might also point out in the FHA concept you have a spreading of risks throughout the country, and the premium of a good loan, the premium incomes from good loans in this city or this State can offset a bad situation in another State, so you have this universal spreading of risks.

In our institutions, each institution has to keep its own reserves for its own loans in that community, and we do not have this sharing.

Senator GORE. Would you mind giving me the percentage of bad debt losses which your institution has experienced from 1950 to 1960?

Mr. BUBB. No, sir. We will be very happy to supply it to you. (See p. 1390.)

Mr. STRUNK. If we can secure the information.

Senator GORE. This business of supplying information for the record—none of us has any time to go back and read it.

You run your institutions, and do you know what your losses have been?

Mr. BUBB. Yes, sir. I do not have any losses.

Senator GORE. Do you know of any building and loan associations which have?

Mr. BUBB. Yes, I do.

Senator GORE. I have not heard of any.

Mr. BUBB. We could name you some cities in the United States where they are having serious losses now.

Senator GORE. Will you name them?

Mr. MCKENNA. Senator, perhaps we can tell you something of the situation and, perhaps, after the meeting we will give you the names of the cities.

Senator GORE. Is there anything confidential about that?

Mr. MCKENNA. Well, I think it would have a certain reaction.

Senator GORE. Is there national security involved?

Mr. BUBB. It would have a very severe effect on the savings and loans in those cities if it were to be published.

Mr. MCKENNA. We can state that in a medium-sized city in which the amount of property sold under foreclosure prior to 1960 was approximately $1.9 million, that by the end of 1960 it was $13.7 million.

This is a serious situation. If the Senator wants these details we will be very happy to furnish them, furnish details to him as to the specific cities.

Senator GORE. I do not wish to bring out any information that would hurt anyone. I am just trying to get at facts.

Mr. BUBB. We certainly do not want to hide any information from you, Senator, or anyone else. But publicly, you know, if we say here today the stress that some savings and loans are in certain cities in the United States, it could cause a run on them, and it just would not be the thing to do.

Senator GORE. As I understand it, you seriously do wish to contend, or submit a plea, that the bad debt reserve should be many times larger than the actual experience for a decade, and even many times larger than the FHA has set up?

Mr. BUBB. Yes, sir.

Senator GORE. How many times larger?

Mr. BUBB. We have felt all along, of course, that the 12 percent bad debt reserve was the proper reserve come another depression. But, of course, as you know, the law passed or the bill passed by the House of Representatives says nothing about the percentage of the bad debt reserve. It just allows you to put 60 percent of your income into that bad debt reserve which we hope will be sufficient to allow us to continue to grow.

Senator GORE. I was laboring under the impression that Congress should proceed to reduce the reserve. But you would not be agreeable to that?

Mr. BUBB. Certainly not.

Mr. MCKENNA. Senator, I think the fact that we have had no losses in the 1950's merely exemplifies the type of exposure we have. It is almost impossible to make a reasonably good loan at a time when the real estate values are appreciating and lose on that loan and, conversely, it is very difficult not to suffer losses on your loans when you have real estate depreciation which exceeds price appreciation.

I think it is as simple as that. This merely exemplifies we have built into our portfolio losses. They are there.

Senator BENNETT. Will the Senator yield to me?

Senator GORE. Yes.

Senator BENNETT. Before you came in, I questioned the witnesses, and they indicated that in the 1950's their losses were about 1 percent or less, and that they were going to——

Senator GORE. I was here.

Senator BENNETT. Were you?

Senator GORE. I understood you to quote some gentleman who testified yesterday.

Senator BENNETT. Yes, and I understood they agreed with me that was an accurate or reasonable statement.

Senator GORE. Or less. I do not think it even approaches 1 percent.

Senator BENNETT. That is right.

Senator GORE. But I did hear the Senator.

Senator BENNETT. I did not realize that.

Senator GORE. Yes.

As I understand it, sir, you represent or are connected with a stock company?

Mr. MCKENNA. I am a practicing lawyer, and I am here by sufferance of the league to help them. My individual clients are large mutuals and stock companies, but I have no personal officership in any association.

Senator GORE. I was not impugning anything. I was trying to elevate you.

Mr. McKENNA. I should like to have such interests, but I do not have any such officership.

Senator GORE. I was not really implying an interest. I understood from your response to Senator Curtis and the deference to you by the panel, that the operation of the stock companies was a field on which you were qualified to speak.

Mr. McKENNA. I would guess somebody thought there were some legal factors in the question, and I am a lawyer, and I will assume, too, also familiarity with their operations.

Senator GORE. I thought Senator Curtis asked a question in a field that requires exploration. I am not learned in this field in any respect, but it strikes me that it is obtuse to permit a private stock company to have full advantage of tax provisions which are designed, or were designed primarily, for mutual concerns. Would you comment upon that?

Mr. McKENNA. Well, first, Senator, I would say this: our justification for our reserves is that they are true bad debt reserves needed for the attrition of capital represented in our annual interest payments.

Now, if that is true, then any business which has the same operations, the same portfolio, needs them as much as any other business, if we assume that.

In other words, there is no area of the country that I know of where the stock companies are competing only among themselves and not with mutuals. Every place I know of they must face the competition of mutuals. Presumably they are doing the same type of operating, and presumably they have the same or comparable losses built into their portfolio.

Senator GORE. Then you think that our tax law should apply the same way to mutuals and to stock companies?

Mr. McKENNA. Basically. You have some differences in the statute now. For example, the 3-percent formula probably is not usable by stock companies. I do not know, I have not explored that, and your section F provides the difference. This point we do not want to forget that these allocations to reserves are not sums which can be removed for distribution to the stockholders without paying a tax. There cannot be any distribution that I know of to a stockholder of a savings and loan without paying a normal corporate income tax.

Now, there can be, of course, under a different section of the law, under section 591. The distributions to the shareholders, the savings account holders, are deductible from gross income to determine taxable income, but that is not true for distributions——

Senator GORE. Are you saying a distribution to stockholders should be made, and under the bill are made, from that portion of the assets on which taxes have been paid?

Mr. McKENNA. I say they must be. There can be no distribution to a stockholder except by the corporation first paying its normal income tax and then distributing the remainder to the stockholder.

Senator GORE. You mean there must be and can only be, according to the terms of the law?

Mr. McKENNA. Yes; and this section is not before the committee, by the way. We are talking now about section 591. The committee is discussing section 593. Section 591 provides that distributions to savings accounts holders, dividends to savings accounts holders, are deductible by the corporation as expenses.

It also inferentially implies that such distributions to shockholders are not deductible, and that is the effect of it.

So that when the stock associations are treated differently in this massive respect that when there is a distribution to a savings account holder it is deductible; when it is a distribution to a stockholder it is not deductible.

Senator GORE. Well, even though there may be testimony on a particular section, it seems to me the entire subject is under consideration, and it would appear to me, my tentative impression is, that it would be inequitable and unfair to permit entirely private stock companies in this field to take advantage of tax provisions that are designed for and, indeed, intended to serve, only mutual concerns.

I think that the House bill may be faulty in that regard, and also it is highly questionable to me whether that the distribution to stockholders comes only from that portion of the assets on which taxes have been paid.

I think it might very well be that the distribution can come from that portion on which taxes have not been paid and, therefore, when distribution is made taxes would be paid.

Mr. McKENNA. Well, if I may explain, Senator, if there is a distribution to a stockholder now it must, the corporation must, first pay the tax and then distribute the remainder. If there is any future distribution, a liquidation, for example, so that there would be a distribution out of pretax reserves, then at that time the amount of those reserves must be taken into undivided profits, the full corporate taxpay, and only then the distribution made to the stockholder. There is not any way of getting this money out for the stockholders without paying first the normal corporate income tax. I believe that is true.

Senator GORE. I was not making that point. It seems to me a larger percentage of it should be subject to tax. That was the point I was getting at.

Now, as I understand it, the House bill would require the payment of approximately $200 million from your institutions; is that correct?

Mr. BUBB. That is correct.

Senator GORE. What were the net earnings of the industry in 1961?

Mr. BUBB. Approximately $650 million.

Mr. STRUNK. Senator, $650 million was the amount we put into reserves last year.

Senator GORE. I am speaking of the net operating income.

Mr. BUBB. That is our net operating income. Our net operating income——

Senator GORE. That was about $6 billion, was it not?

Mr. BUBB. Oh, no, no. You have got to pay your dividends out of that.

Mr. STRUNK. We call it dividends, but to most people it is called interest payments to savers for the use of their money.

Senator GORE. I am not talking about your distributions to your—I am talking about your net operating income.

Mr. BUBB. All right. After the distribution to savers our net operating income was about $650 million.

Senator GORE. What was your distribution?

Mr. BUBB. Have you got that in the factbook?

Senator GORE. You have to make a distribution out of your net operating income, don't you?

Mr. BUBB. It depends on what you call net operating income. No, sir. The net operating income is what is left over after you pay your expenses and your dividends.

Mr. MCKENNA. You see, Senator, our dividends are actually treated as interest payments by the Internal Revenue Code under section 591, and I think that is the point.

Senator GORE. I see we are having difficulty using the same terms. I am waiting for the figure.

Mr. BUBB. 1960, Senator Gore, we paid out $2,183,492,000 in dividends.

Senator GORE. I did not understand, I am sorry.

Mr. BUBB. In 1960 we paid out $2,183,492,000 in dividends.

In that same year we paid about $560 million we had left over as net operating income which went into reserves.

Senator GORE. Mr. Chairman, I would like one of the staff members for the committee, Mr. Woodworth, to state the provision in the House bill which we have been discussing. I think there is either some misunderstanding on my part or on the part of the panel, if you would not mind.

The CHAIRMAN. That will be done, without objection.

Mr. WOODWORTH. There was a committee amendment on the floor of the House which provided that in the case of the stock companies the first amounts paid out are the earnings and profits on which the tax has already been paid. When these amounts are paid out, the company pays no further tax at the time of distribution and only when these amounts are exhausted are distributions considered as coming out of reserves on which tax has to be paid at the time of distribution.

I believe from the questioning that Senator Gore thought you did not agree with that.

Mr. MCKENNA. I do not disagree with that. What I am saying is I thought we were referring particularly in the question which was They, the tax must first be paid, and for any amounts which are ac-no taxes had been paid, and the distribution of those to stockholders.

Now, as to any amounts which are distributed out of current income. They, the tax must first be paid, and for any amouths which are accumulated since 1951, either the taxes have been paid and they are now in undivided profits or the taxes must be paid before the amounts are distributed to stockholders.

Mr. WOODWORTH. The amounts on which tax are paid currently, that is, the 40 percent, assuming this is the method which you use, under the House bill, can be paid out by the company without any further tax.

I think under the House bill the issue is whether this should be paid out first, or whether the first amount paid out should be the amount in the reserves on which no tax has as yet been paid.

Mr. MCKENNA. But after the normal 30, 52-percent tax has been paid.

Mr. WOODWORTH. In other words, after tax has been paid, on these funds, these funds can be paid out in subsequent years without payment of any further tax.

Mr. MCKENNA. Oh, yes. I did not imply that was a second type of tax here.

Mr. WOODWORTH. I think that was the misunderstanding.

Senator GORE. Thank you. I think that clarifies the situation.

Senator DOUGLAS. Mr. Chairman, may I ask a question?

The CHAIRMAN. Senator Douglas.

Senator DOUGLAS. Mr. Bubb, in rereading your testimony, there was a sentence which struck me. It reads:

> If a withholding tax is imposed, savings and loan associations will deposit more than half a billion dollars of our withheld dividends each year in the commercial banks, who will add it to their tax and loan accounts, the huge balances of which banks use to generate corporate profits. They will pay nothing to anybody for the use of our savers' dividends, as they pay nothing now for the use of the Government's money in these accounts.

Now, in my ignorance I thought that you would pay the taxes to the Collector of Internal Revenue.

Mr. BUBB. We do not under present withholding tax law on salaries, Senator Douglas, and we presume that the Treasury would handle this the same way.

We deposit the money in a bank as we collect it now, and the bank holds it until the Treasury draws on it.

Senator DOUGLAS. You mean that out of each week's paychecks you will withhold 20 percent?

Mr. BUBB. We withhold 20 percent and we have to deposit it in a commercial bank, and the commercial bank——

Senator DOUGLAS. Not to the Collector of Internal Revenue?

Mr. BUBB. No, sir; and the commercial bank holds that money until the Government draws on it.

Senator DOUGLAS. Do you know whether the Government gets any interest on these deposits?

Mr. BUBB. No, sir; they do not.

Senator DOUGLAS. When will the banks remit the money to the Collector of Internal Revenue?

Mr. BUBB. There is no definite time, the way I understand it. I happen to be a director of a bank also, and I know in our bank the Government makes a call on that money every now and then. It draws it down as it needs it.

Senator GORE. You do not pay the 4 percent, your bank does not pay the 4 percent, which the Federal Reserve Bank has authorized?

Mr. BUBB. Not on that money; no. They pay nothing on it. We pay 4 percent to other savers.

Mr. STRUNK. This goes in that tax and loan account, and the money goes in there, and the Government draws on it from time to time. In the meantime the bank has the use of this money interest free.

Mr. BUBB. Unless you write it in this bill, that is different the way it is now; we naturally assumed the Treasury would force us to put this money in the same tax and loan accounts in which we put withholding on wages and salaries at the present time.

Senator DOUGLAS. Is it your contention that the commercial banks can then invest this money in short-term securities?

Mr. BUBB. They do.

Senator DOUGLAS. Current bills, notes, 90-day loans, and so forth?
Mr. BUBB. Yes, sir; they do now; yes, sir.
Senator DOUGLAS. And collect interest?
Mr. BUBB. Yes, sir.
Senator DOUGLAS. Well, that is a very interesting thing. [Laughter.]
May I ask another question? I have been struck with the fact that you have a considerable number of mutuals where the managers who are, in effect, the moving forces within the mutuals, try to switch the mutuals to a stock savings and loan association. I have been puzzled as to what the motives are in the switches. I wonder if either you or your counsel here could tell us about it.
Mr. BUBB. I presume one motive is personal gain.
Senator DOUGLAS. You mean the managers of the mutuals believe they can make more money if they become stock companies than if they remain mutuals?
Mr. BUBB. Well, that is the presumption that they work under, of course.
Senator DOUGLAS. How is this done? How can they make more money?
Mr. BUBB. Well, just recently, I might point out, Senator, the Federal Home Loan Bank Board has passed a new conversion regulation, and if the terms of that regulation are followed, I doubt if very much money would be made by the manager of a mutual.
For many years we in the industry have been trying to get such a regulation put into effect, but there is a regulation in effect now that I think will make all conversions——
Senator DOUGLAS. What was the profit before the regulation?
Mr. BUBB. There is not any profit unless they sell out.
Senator DOUGLAS. Well, you tell me that these conversions took place because the managers believed that they could make more profits on a stock basis rather than on a mutual basis. In what ways could this have been done in the past?
Mr. BUBB. The only ways it could have been done would be if they had sold their stock to some other company or individual or corporation or if they died they had an estate which they could pass on.
Senator DOUGLAS. What would happen to the members of the association who became members upon deposit?
Mr. BUBB. Of course, for all practical purposes there was no different treatment to the members after they changed the capital stock than when they were a mutual. The saver still had his account, he still had it insured, he still got the same amount of dividends, and in some cases an increased dividend.
I think the only thing you have in mind, knowing you for your fairness, sir, is the conversions that have taken place without any regulations, and I think with the new regulation passed by the Federal Home Loan Bank Board, those things will all be cleared up.
Senator DOUGLAS. In what ways will the regulation by the Home Loan Bank Board clear up this matter. What protections are there? Mr. McKenna, do you want to answer that?
Mr. MCKENNA. Yes. This is really an interpretation of the act the Congress passed a dozen years ago in which it said that any conversion from mutual to guarantee stock must be on a basis that is fair and equitable in the eyes of the insurance corporation.

The new regulation takes in all contingent elements of value, including even "going concern" value, in determining what the value of that association is. So when it is sold, when it ceases to become a mutual or becomes a guarantee stock or permanent stock, whoever buys that stock presumably must pay what the stock is worth and, therefore, make no unconscionable profit.

Senator DOUGLAS. What about the goodwill features?

Mr. McKENNA. It is my understanding that it is to be considered in determining the value from now on, by the insurance corporation.

Goodwill is one of the factors to determine whether or not the terms of the conversion are fair and equitable. If that is true then there should not be any possibility here of unconscionable profit.

Senator DOUGLAS. I am informed by my assistant the regulations do not require goodwill to be considered by merely that goodwill may be considered. Is he correct on that?

Mr. McKENNA. Well, I think we are merely interpreting the word. The language or the regulation is——

Senator DOUGLAS. Is it mandatory that goodwill should be taken into account or merely optional?

Mr. McKENNA. If we are talking about the level of the Bank Board, it is not mandatory that the Bank Board take it into account. But it would be a fair assumption that the Bank Board is going o make it mandatory for the ownership to take it into account because this is the language used, and in passing upon any such plan the Board, that is the Bank Board, may give consideration to any element of goodwill value. So it is not mandatory on the Bank Board, but I should hope it would be mandatory on the management if there really is a goodwill value.

Senator DOUGLAS. Would you favor tightening this up so that it would be mandatory either upon the mutuals or upon the Board under any administrative regulations that would require it?

Mr. McKENNA. Senator, I would agree that nobody should make any profits from changing a mutual into a stock company, and I think that was the plain intent of Congress 12 years ago when it wrote the words "fair and equitable" into the homeowner bank law.

Senator DOUGLAS. I always though it was.

Mr. McKENNA. I think the bank has an obligation to see that nobody makes an unconscionable profit.

Senator DOUGLAS. Does Congress have the obligation?

Mr. McKENNA. The Bank Board is an agency of Congress.

Senator DOUGLAS. I know, but sometimes it operates on its own.

Mr. McKENNA. Then I certainly think if it is not taken into consideration that Congress should see that it is.

Mr. STRUNK. I would give an affirmative answer to your question, just personally.

Senator DOUGLAS. That is very constructive; it is a very constructive attitude. I want to commend you.

Mr. BUBB. Thank you, sir.

Senator BENNETT. Mr. Chairman, may I ask one brief question?

The CHAIRMAN. Senator Bennett.

Senator BENNETT. Are there in the various States levels of required reserve, levels set by the State authority?

Mr. BUBB. Yes, sir.

Senator BENNETT. Could you submit for this committee a table showing the level of these required reserves?

Mr. BUBB. Yes, sir.

Mr. STRUNK. I happen to have it here somewhere.

Senator BENNETT. This argument has turned on the question of whether the reserves are adequate or inadequate, whether or not they are excessive, and I assume that you would say that you had to meet the required reserve levels of the State in which you operate——

Mr. BUBB. Well, all State chartered do; yes, sir. The Federals have to meet the required reserves of the Federal Home Loan Bank Board.

Senator BENNETT. Will you submit also the required reserves of the Federal Home Loan Bank Board?

Mr. BUBB. Yes, sir.

Senator BENNETT. They are all in this statement?

Mr. BUBB. Yes, sir; they are all there.

(The document referred to follows:)

LEGAL RESERVE REQUIREMENTS FOR SAVINGS AND LOAN ASSOCIATIONS

(Prepared by legal department, U.S. Savings and Loan League, June 16, 1961)

INSURED STATE AND FEDERAL ASSOCIATIONS

Federal insurance reserve

Section 403(b) (12 U.S.C. 1726) requires, among other things, that insured associations "will provide adequate reserves satisfactory to the Corporation, to be established in accordance with regulations made by the Corporation, before paying dividends to its insured members; but such regulations shall require the building up of reserves to 5 per centum of all insure accounts within a reasonable period, not exceeding twenty years, and shall prohibit the payment of dividends from such reserves, or the payment of any dividends, if any losses are chargeable to such reserves: *Provided*, That for any year dividends may be declared and paid when losses are chargeable to such reserves if the declaration of such dividends in such case is approved by the Corporation."

Rules and regulations for insurance of accounts

12 CFR, sec. 563.13: (a) [This portion of the regulation requires an insured association during its first 20 years of insurance to add annually to its Federal insurance reserve an amount at least three-tenths of 1 percent of its insured acounts, meet annual benchmarks, and to achieve at least 5 percent at the end of the period. If benchmarks are not met, association must allocate 25 percent of net income to such reserve. If 5 percent is not reached in 20 years, the institution becomes a supervisory case.] * * *

(c) [After the 20-year anniversary, an insured association shall, during each] such fiscal year, credit from net income, or from surplus or undivided profits not so earmarked, to its Federal insurance reserve account or to other reserve accounts irrevocably established for the sole purpose of absorbing losses, an amount equal to at least 10 percent of its net income or the amount by which the total of such reserve accounts and of nonwithdrawable accounts (as defined in section 561.4 of these rules and regulations), undivided profits, surplus, and reserve

for bad debts is, at the close of such fiscal year, less than 12 percent of all insured accounts at the close of such fiscal year * * * If for any reason the Federal insurance reserve account, together with any undivided profits earmarked pursuant to paragraph (b) of this section, of any insured institution which has passed the 20th anniversary of the date of insurance of its accounts and which has built up its Federal insurance reserve account (including undivided profits, if any, so earmarked) to an amount equal to at least 5 percent of all insured accounts is, at the closing of any fiscal year, less than an amount equal to 5 percent of all insured accounts at the beginning of such fiscal year, such institution shall either (1) credit to its Federal insurance reserve account, during such fiscal year, an amount equal to at least 25 percent of its net income, or (2) credit to its Federal insurance reserve account, during such fiscal year, an amount at least equal to such part of such 25 percent as may be sufficient to cause the amount of such reserve account (including undivided profits, if any, so earmarked) at the close of such fiscal year to equal at least 5 percent of all insured accounts at the beginning of such fiscal year and (if such fiscal year is after that in which occurs the 20th anniversary of the date of insurance of its accounts) credit, during such fiscal year, from net income, or from surplus or undivided profits not so earmarked, to the Federal insurance reserve account or to other reserve accounts irrevocably established for the sole purpose of absorbing losses, an amount equal to at least (i) the remainder of such 25 percent, (ii) 10 percent of its net income, or (iii) the amount by which the total of such reserve account and of nonwithdrawable acounts (as defined in section 561.4 of this subchapter), undivided profits, surplus, and reserve for bad debts is, at the close of such fiscal year, less than 12 percent of all insured accounts at the close of such fiscal year."

FEDERAL ASSOCIATIONS

The Federal Home Loan Bank Board, under authority of 12 United States Code 1464(a), is empowered to issue charters and regulate Federal savings and loan associations. Part 544, section 1, setting out charter for associations, provides reserve requirements as follows (sec. 10, charter K (Rev.)):

"Reserves, surplus, and distribution of earnings. The association shall maintain general reserves for the sole purpose of meeting losses; such reserves shall include the reserve required for insurance of accounts. Any losses may be charged against general reserves. If and whenever the general reserves of the association are not equal to at least 10 percent of its capital, it shall, as of June 30 and December 31 of each year, credit to such reserves an amount equivalent to at least 5 percent of its net earnings for the 6 months period, or such amount as may be required by the Federal Savings and Loan Insurance Corporation, whichever is greater, until such reserves are equal to at least 10 percent of the association's capital. As of June 30 and December 31 of each year, after payment or provision for payment of all expenses, credits to general reserves and such credits to surplus as the board of directors may determine, the provision for bonus on savings accounts as authorized by regulations made by the Federal Home Loan Bank Board, the board of directors of the association shall cause the remainder of the net earnings of the association for the 6 months period to be distributed promptly on its savings accounts, ratably, as declared by the board of directors, to the withdrawal value thereof; in lieu of or in addition to such net earnings, any of the association's surplus funds may be likewise distributed. Such net earnings shall be credited to savings accounts or paid, as directed by the owner. * * *"

State associations

State	Name by which loss reserve is known	Statutory requirements
Alabama	General reserve	Before declaration of dividend, association must each semiannual period transfer to reserve set up for sole purpose of absorbing losses an amount equal to 5 percent of net earnings until reserve equals 10 percent of capital. Title 5, sec. 223.
Alaska	General reserve	Before declaration of dividend, for sole purpose of absorbing losses, an amount equal to 10 percent of net earnings until the general reserve is equal to at least 12 percent of the savings liability. Senate bill 40, laws 1961, sec. 18.
Arizona	Contingent reserve	When total amount of reserve is less than 10 percent of aggregate withdrawal value of association's accounts, allocation to reserve must be not less than 10 percent of profits being apportioned or such lesser portion as will increase reserve to required total amount. Title 6, ch. 3, sec. 6-441.
Arkansas	Contingent reserve fund	5 percent of net earnings set aside at each distribution of profits until fund reaches 5 percent of assets, fund to be used only in payment of losses sustained. Title 67, sec. 827.
California	Loan reserve	Before declaring dividends, loan reserve of not less than 5 percent of net profits accruing since last apportionment shall be set aside each time to be continued until the reserve amounts to at least 5 percent of the aggregate unpaid principal amount of loans in force secured by real property. Financial Code, sec. 6950.
Colorado	Contingent reserve	5 percent of net earnings on semiannual closing dates until reserve equals 10 percent of invested capital, less permanent stock; may be increased over the 10-percent requirement with approval of commissioner; reserve may be designated Federal insurance reserve to extent such reserve required to be set up and maintained. Col. Rev. Stats., secs. 122-2-17, 122-3-11.
Connecticut	Fund for contingent losses	At least 10 percent of net income each year until it reaches at least 10 percent of the gross amount invested in mortgage loans and in real estate. Sec. 2732d, Banking Law.
Delaware	Contingent fund	Apparently permissive. Title 5, sec. 1914.
Florida	Reserve for contingencies	From gross profits, at least 4 percent annually after the 2d year of operation against which reserve losses may be charged whether resulting from depreciation or otherwise, until total amount of funds equals 10 percent of assets. Any excess of undivided profits, over 4 percent after dividends declaration and deduction of expenses shall be carried to reserve until 10 percent reserve is accumulated. Fla. Stats. Ann., sec. 665.28.
Georgia	General reserve	For sole purpose of absorbing losses. Before declaration of dividend for semiannual period, association shall transfer amount equal to 5 percent of earnings (net) until general reserve is equal to 10 percent of capital. Regulation 5.
Hawaii	General reserve	For sole purpose of absorbing losses, there shall be transferred an amount not less than 5 percent nor more than 20 percent of net earnings until reserve is equal to at least 10 percent of aggregate book value of outstanding withdrawable shares and investment certificates. Federal insurance reserve may be maintained in lieu of general reserve. Revised Laws of Hawaii, sec. 180-45.
Idaho	No provisions	
Illinois	Contingent reserve	When total amount of reserve is less than 7½ percent of aggregate withdrawal value of association's withdrawable capital accounts allocation at time of apportionment of profits shall be not less than 10 percent of profits or such lesser portion as is necessary to reach required amount. Ch. 32, sec. 772.
Indiana	Fund for contingent losses	Association must set aside from gross profits at least 3 percent per year as sinking fund for contingent losses until total amount equals 10 percent of total assets. Any losses incurred are to be charged against such fund—any losses sustained from investments, whether resulting from depreciation or otherwise. (Federal insurance reserve transfers will effect compliance if equal to 3 percent of gross profits.) Title 18, sec. 272.

State associations—Continued

State	Name by which loss reserve is known	Statutory requirements
Iowa	Reserve for contingencies or general reserve account.	Semiannually before declaration of dividends, an amount not less than 2 percent of earnings to reserve until it is equal to at least 5 percent of total amount paid in by members and credited to share accounts—maintained for sole purpose of absorbing losses incurred by association and for no other purpose. Iowa Code Ann. sec. 534.43.
Kansas	General reserve	Before declaration of dividend, association shall transfer to general reserve for sole purpose of absorbing losses an amount equal to at least 5 percent of net earnings until reserve is equal to at least 5 percent of liabilities and capital except reserve stock or 50 percent of total book value of real estate owned, judgments, loans in foreclosure and real estate contracts on which there is an unpaid balance in excess of 80 percent of sale price, whichever is greater. Kan. Stats. sec. 17-5409.
Kentucky	Reserve fund	Association must set aside at least 1 percent of gross profits as reserve fund to provide against contingent losses, until total amount of fund equals 20 percent of assets. Director of Banking may require other specific reserve in his discretion. Rev. Stats. sec. 289.260.
Louisiana	Contingent loss account	From net earnings, at least 3 percent as account for payment of contingent losses until account reaches 5 percent of outstanding loans and immovable property (real estate). All losses shall be charged to contingent loss account and not to periodical operations. Rev. Stats. sec. 6:774.
Maine	Guaranty fund	Association must set aside sum at rate not less than 10 percent per year of net income until guaranty fund amounts to 5 percent of withdrawable accounts—funds to be kept constantly on hand as security against losses and contingencies. If fund drops below required amount, association must set aside from current income amount equal to at least ½ of 1 percent of withdrawable accounts until fund is restored to required amount. Federal Insurance reserve may be designated as guaranty fund. Rev. Stats., ch. 59, sec. 157-Z-18.
Maryland	General reserve fund (code passed but provisional upon referendum now).	To be used solely for purpose of absorbing losses—profits to be allocated to fund as determined by directors but, when total amount of reserve is less than 6 percent of aggregate withdrawal value of free share accounts, allocation must be not less than 10 percent of profits. Ann. Code, art. 23, sec. 161EE.
Massachusetts	Guaranty fund	5 percent of net profits must be transferred to fund each distribution date until fund is at least equal to 10 percent of assets of corporation purpose to meet losses in its business from depreciation, disposal or other change in its assets. Genl. Laws ch. 170, sec. 38.
Michigan	Legal reserve account	For sole purpose of absorbing losses, an amount must be transferred to reserve of not less than 5 percent of earnings after payment of expenses until reserve totals not less than 10 percent of savings account liability. Any portion of legal reserve may serve as Federal Insurance reserve. Mich. Laws 489.24.
Minnesota	Contingent or reserve fund	At least 2 percent semiannually of net earnings until fund equals at least 25 percent of accumulated capital, or at least 50 percent of book value of all real estate owned by it, whichever is greater. For insured association, FSLIC reserve requirements to be substituted for this section, provided the reserve at least equals the amount required above. In the case of an insured association, the reserve required by FSLIC may be counted when computing the State reserve requirements. (For losses on investments.) Sec. 51.24, Minn. Statutes.
Mississippi		No statutory provisions.
Missouri	Contingent fund or general reserve.	At least 10 percent semiannually of net earnings until fund equals 10 percent of total assets less cash on hand, FHLB stock, and certain bonds. (Sole purpose of absorbing losses.) Sec. 369.210, Mo. Savings and Loan Statutes.
Montana	Fund for contingent losses	For serial or permanent associations, at least 5 percent of net earnings until fund reaches at least 5 percent of book value of stock. For other associations, amount to be set by directors. (To pay losses.) Rev. Stat. 1947, title 7-120.

State associations—Continued

State	Name by which loss reserve is known	Statutory requirements
Nebraska	Reserve fund for contingent losses.	At least 5 percent of net earnings each year until fund reaches at least 5 percent of total assets exclusive of cash on hand. (For payment of contingent losses.) Sec. 8-326.
Nevada	Reserve for losses	Stock plus total of surplus, undivided profits and all reserves available for losses must equal 5 percent of outstanding investment certificates. Sec. 673.273, Nev. Rev. Stats.
New Hampshire	Guaranty fund	Not less than 5 percent of net profits until fund amounts to not less than 5 nor more than 20 percent of total liabilities. (To be used to pay losses). Sec. 393.26, N.H. Rev. Stats.
New Jersey	General reserve account; also may establish a bad debt reserve account, and Federal insurance reserve account.	At end of each accounting period, 10 percent of net income less any amounts transferred for such period to the bad debt reserve account and the Federal Insurance reserve account, must be allocated to the general reserve account. May be allocated from income, undivided profits or other unapportioned profits. Further allocations optional after amount held in all reserve accounts plus amount in the undivided profits account, equals or exceeds an amount equal to 12 percent of the association's capital. (For absorbing losses 17:12A-60 Rev. Stat.
New Mexico	Reserve fund for protection against losses.	2 percent at each dividend period of net earnings until fund is accumulated of from 3 percent to 20 percent of total assets. (For protection against losses) 48-15-12, New Mexico Stats.
New York	Surplus account	If surplus does not equal 10 percent of capital and 50 percent of book value of real estate held by it, 1/20th of net profits to be credited until the greater of the above is reached. May allocate freely to this account until it and undivided profits reach 25 percent of capital, at which time State Superintendent may direct payment of dividends of any excess amount. (For losses on investments or loans, whether from depreciation or otherwise.) Ch. 2, Consolidated Laws, secs. 385 and 387.
North Carolina	Reserve fund	Semiannual allocation of 10 percent of net earnings until fund is at least 5 percent of outstanding shares. Reserves required by FSLIC can be counted in meeting the State requirement. Reserve fund shall be available to pay all losses. 54-41.1 Gen. Stats.
North Dakota	Reserve fund	At least 5 percent of net earnings each year until fund reaches at least 5 percent of assets. (For payment of all losses.) Title 7, sec. 0411.
Ohio	Reserve fund	In permanent or perpetual associations, at least 5 percent of net earnings each year until fund reaches at least 10 percent of total assets. (To pay contingent losses.) Sec. 9671, Ohio General Code. (Also known as sec. 1151.50, building and loan law.)
Oklahoma	Reserve fund	(Statute provides for building and loan board to set rules.) Regulation: At least 5 percent of net earnings at each dividend period until fund amounts to 5 percent of total assets. (For payment of losses.) Title 18, sec. 315, Okla. Stats Ann.
Oregon	Contingent fund	Mutuals: Not less than 5 percent of interest income during year until fund amounts to at least 5 percent of its paid-in capital up to $20,000,000, and 2½ percent of paid-in capital in excess of $20,000,000. When such fund equals this required amount, then the association shall pay into the contingent fund an amount equal to 10 percent of its net earnings each year. Reserve fund associations: Fund shall consist of amount paid on reserve fund stock plus such portion of surplus and undivided profits as to equal 5 percent of 1st $20,000,000 of liabilities and 2½ percent of liabilities in excess of $20,000,000. When fund falls below this level, 15 percent of net income must be allocated before dividends until fund requirement is reached. When fund reaches the required amount, annual allocation of not less than 10 percent of net earnings is required. Associations subject to Federal insurance requirements may include insurance reserve requirements in computing the amount of the contingent fund required by the State. Sec. 722.150. Oregon Laws.

State associations—Continued

State	Name by which loss reserve is known	Statutory requirements
Pennsylvania	3 general reserves permitted: reserve for contingent losses; reserve for bad debts; Federal insurance reserve.	General reserves must equal 8 percent of the participating value of all outstanding shares, and the aggregate general reserves and undivided profits must equal at least 12 percent of such participation value. Whenever such requirements are not met, annual allocation of 5 percent of net income is required: provided, no profits shall be allocated to reserves after they exceed 20 percent of assets unless banking department approves. (To be used solely for the purpose of absorbing losses.) Sec. 620, Savings and Loan Act.
Rhode Island	Guaranty fund for payment of bad debts.	Not less than 2 percent annually of net profits until fund equals at least 5 percent but not more than 15 percent of assets. Sec. 19-23-6, General Laws.
South Carolina		No statutory provisions.
South Dakota	Contingent fund or surplus account.	At least 5 percent of semiannual net earnings until fund equals at least 5 percent of share accounts. (For sole purpose of absorbing losses.) Sec. 7.0415 S. Dak. Code.
Tennessee	Reserve or surplus account	"Such sum(s) as board of directors may deem reasonably necessary and proper." (To provide against contingencies and for safe conduct of the business.) Sec. 3907, Tenn. Code (1950).
Texas	Reserve fund	Not less than 5 percent of net profits semiannually until fund amounts to at least 5 percent of capital of association. (To meet losses arising from any source.) Art. 881a-41 Rev. Civil Stat.
Utah	Reserve account	Mutuals: 5 percent of net profits semiannually until aggregate reserves equal at least 10 percent of its liability on outstanding stock. Permanent capital: Same as above, except that in computing 10 percent, value of permanent stock to be included. (Sole purpose of absorbing losses.) Sec. 7-7-9, Utah Code.
Vermont	Reserve account	5 percent of net earnings semiannually until reserve equals 10 percent of its capital. (Sole purpose of absorbing losses.) Sec. 8950.
Virginia	Reserve	Required allocation of 5 percent of annual net income until reserve is at least 10 percent of total resources, provided that whenever at end of fiscal year said reserve is less than 5 percent of the association's share accounts at beginning of the year, then an allocation of up to 25 percent of net income is required to bring reserve up to the required 5 percent of share accounts. Sec. 6-208.28 Stats. of Va.
Washington	Contingent fund	Constitutes a reserve for absorption of losses; semiannually association must credit to fund an amount equal to 2 percent of amount by which aggregate of loans and real estate contracts outstanding at end of 6-months period exceeds the amount of such loans and contracts outstanding at the beginning of such period or 1/20th of 1 percent of total savings accounts at end of period, whichever is greater, sum to be credited in no event to be less than 5 percent of net earnings for the period. Federal insurance reserve may be incorporated into contingent fund. When aggregate of contingent fund, undivided profits and other reserves except those allocated for specific losses exceeds 10 percent of savings accounts credits to funds are not required. Revised code, sec. 33.12.150.
West Virginia	Contingent reserve	At least 5 percent of net earnings since last dividend date until reserve equals 10 percent of assets. Reserve to be used only for purpose of making good losses suffered on loans and expenses incurred in collections of loans which may not be charged against or collected from borrower. W. Va. Code, ch. 31, art. 6, sec. 25.
Wisconsin	Legal reserve	Used for payment of all losses. 3/10 of 1 percent per annum of total share and creditor liability transferred from net income to reserve until reserve reaches 5 percent of share and creditor liability. Legal reserve may be designated as Federal insurance reserve. Legal reserve is mandatory to 5 percent, permissive but irrevocable to 10 percent. Wis. Stats., sec. 215.33.
Wyoming	Contingent fund	At each periodical distribution of profits, 5 percent of net earnings must be credited to fund until it is equal to at least 5 percent of amount credited to members. Losses of association may be paid therefrom. Wyo. Stats., sec. 36-114.

The CHAIRMAN. The committee will recess until 3 o'clock.

(Whereupon, at 12:10 p.m., the committee was recessed, to reconvene at 3 p.m., the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Oscar Kreutz of the National League of Insured Savings Associations.

Senator CARLSON. Mr. Chairman, before Mr. Kreutz starts his testimony, I would like to state that I regret that I was absent this morning when we had a witness before this committee, one of our outstanding citizens, a man who has been president of the United States Savings & Loan League and very active in Kansas, and one of our No. 1 citizens. I shall read his testimony, I assure you.

The CHAIRMAN. We certainly missed you, Senator.

You may proceed, sir.

STATEMENT OF OSCAR R. KREUTZ, LEGISLATIVE CHAIRMAN, NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS; ACCOMPANIED BY BRYCE CURRY, GENERAL COUNSEL

Mr. KREUTZ. Mr. Chairman and gentlemen, my name is Oscar R. Kreutz. I am chairman of the board of First Federal Savings & Loan Association of St. Petersburg. My appearance is for the National League of Insured Savings Associations as its legislation chairman and the Florida Savings & Loan League, of which I am president.

I have with me Mr. Bryce Curry, general counsel, of the National League of Insured Savings Associations.

I want to thank this committee for this opportunity to appear.

We are concerned primarily with section 8 of the act and the amendments that have been offered. In addition we find section 19, establishing a withholding system, compounds the impact of section 8 on our business and the objectives for which it is chartered.

TAX EQUALITY

In the name of so-called tax equality, designed for additional competitive advantage, commercial banks have attacked the existing tax treatment of our business and the revisions contained in section 8 of the bill. "Tax equality" is a slogan which conceals the basic facts upon which sound tax policy must be based.

The slogan presupposes that commercial banks and savings and loan associations each receive and lend their funds on a comparable basis, experience comparable risk, and enjoy comparable tax advantages. What are the facts? As of December 31, 1960, 68 percent of the lendable funds of commercial banks were demand deposits amounting to $155.4 billion on which the payment of interest is prohibited.[1] Savings and loan associations, on the other hand, must pay a return on every dollar obtained from the public.

[1] 1960 Annual Report, FDIC.

Consequently, commercial banks invest substantially in U.S. Government securities and are the largest corporate purchaser of tax-exempt State and municipal securities. For example, in 1960 alone, commercial bank holdings of tax-exempt securities were almost $18 billion, on which they received a tax-free return of approximately $500 million.[2] These holdings of tax-exempt securities have increased by approximately $4 billion since the close of 1960.[3]

At the end of last year, commercial banks held an additional $66.5 billion in U.S. Government securities which are subject to a specialized tax treatment not available to the ordinary corporate taxpayer. In 1942, wartime legislation was enacted permitting financial institutions to expense losses or take a capital gain on the exchange or sale of Government securities. For all practical purposes, however, this tax advantage is limited to commercial banks because of their interest-free demand deposits.

In combination, these features, namely, (1) non-interest-bearing demand deposits, (2) the power to create lendable funds, (3) special tax treatment of security gains and losses, and (4) substantial investments in tax-exempt securities produce unparalleled opportunities for commercial banks to create aftertax profits. This combination of special advantages is unique to commercial banking and is unavailable to any other segment of the financial system.

For example, in 1960, after taking bad-debt reserve deductions and after the payment of taxes, the net profits of commercial banks amounted to 20 percent of their gross operating income.[4] In the same year the net earnings of savings and loan associations before taxes and before allocations to loss reserves were only 15 percent of gross operating income.[5]

This 15 percent was placed in loss reserves. These additions to loss reserves are certainly not comparable to the after-tax profits of commercial banks. Moreover, these reserves are not available for anyone's profit. Under supervisory regulations they are irrevocably frozen as loss reserves. If we assume, however, that these tax deductible allocations might be used for purposes other than losses, they are subject first to full corporate taxes, either under existing law or the bill now before the committee.

THE NEED FOR RESERVES

The "tax equality" slogan further assumes that allowable additions to valuation reserves should be the same for a long-term portfolio as for a predominantly short-term portfolio. It also assumes valuation reserves should be the same for a portfolio confined almost exclusively to long-term real estate loans as for a wide and varied portfolio with maturities predominantly under 1 year.

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[2] Ibid.
[3] Estimate derived from Report of Call No. 55 and Call No. 56, FDIC and Federal Reserve Statistical Release, Series G-7.
[4] 1960 Annual Report, FDIC.
[5] 1960 Combined Financial Statements, members FHLB system, FHLBB.

No evidence is presented to support either assumption. In fact, none exists. Comparative maturities and the degree of diversification have important effects upon the probability of loss, concentration of losses and ability to absorb losses. The reasons are clear:

(1) The short-term lender can control both risk and rate of return more readily. The short-term lender can call loans, adjust collateral requirements, revise the maturities, the rate of return, and indeed the amount of the loan.

(2) The short-term lender is in a better position to measure the probabilities of loss because of the shorter maturity of the loan. It is obviously easier to predict the probabilities of return of principal for 90 days, 120 days, or even 12 months, than it is to predict the return of principal over 25 or 30 years.

(3) The short-term lender can increase sharply and within a comparatively short period the bad-debt reserve ratio to outstanding loans because such lender can effect a prompt and substantial decline in the outstanding loans against which the bad-debt reserves are accumulated. A commercial bank, as a short-term lender, also has the capacity to shift the cash flow resulting from such a reduction in loan portfolio to the securities of Federal, State, and local governments.

(4) The short-term lender normally has collateral more easily acquired and sold in satisfaction of the obligation than the real estate which is the security for a residential mortgage.

The following table shows the major categories of the portfolio of insured commercial banks as of June 30, 1961, including the dollar amounts and percentages for each major category.

(The table referred to follows:)

Loans and discounts of commercial banks, June 30, 1961 [1]

	Amount	Percent of total portfolio
Total loans and discounts	$120,886,248,000	
Less:		
FHA residential loans	5,819,843,000	
½ VA residential loans	1,363,234,000	
Total portfolio eligible for bad debt reserves	113,703,171,000	
TOTAL ELIGIBLE PORTFOLIO		
Real estate loans:		
Secured by farmland	1,716,215,000	1.51
Secured by residential properties:		
½ VA loans	1,363,156,000	1.20
Not insured or guaranteed by FHA or VA	12,049,289,000	10.59
Secured by other properties	7,071,671,000	6.22
Loans to domestic commercial and foreign banks	1,009,423,000	.89
Loans to other financial institutions	6,018,892,000	5.29
Loans to brokers and dealers in securities	2,932,928,000	2.58
Other loans for purchasing securities	1,994,881,000	1.75
Loans to farmers directly guaranteed by the Commodity Credit Corporation	581,643,000	.51
Other loans to farmers (excluding real estate loans)	5,472,627,000	4.81
Commercial and industrial loans (including open market paper)	42,987,481,000	37.80
Other loans to individuals for personal expenditures	(27,395,241,000)	(24.09)
Passenger automobile installment loans	8,969,160,000	7.89
Other retail consumer installment loans	3,156,219,000	2.77
Residential repair and modernization loans	2,662,570,000	2.34
Other installment loans for personal expenditures	4,420,026,000	3.89
Single payment loans for personal expenditures	8,187,266,000	7.20
All other loans (including overdrafts)	3,109,645,000	2.73
Total	113,703,170,000	[2] 100.00

[1] Report of call No. 55 and call No. 56, Federal Deposit Insurance Corporation, p. 2.
[2] Total percentage rounded.

Mr. KREUTZ. A mere glance at the major components of the loan portfolio of insured commercial banks, as shown in this table, underscores the fact that the reserve formula permitted these institutions is not applicable to the portfolio of a savings and loan association. The diversity of type of loan, of borrower, of collateral, and the maturity schedule are so totally different from the single-purpose portfolio of a savings and loan association as to make comparisons in the name of so-called "tax equality" slogan irrelevant to the discussion.

Mortgage loans are not made on a 90- or 120-day basis; nor, on the other hand, is credit extended to brokers or dealers in securities on a 25- or 30-year basis. There is no comparison between the risk in the typical portfolio of a commercial bank and the mortgage portfolio of any savings and loan association, and no similar bad-debt reserve treatment and no slogan of so-called tax equality can make them comparable. Yet here again, this is precisely what the Treasury is still proposing when the Secretary argues as he did in his formal statement before this committee that the income subject to corporate tax in a savings and loan should be the same as for a commercial bank.

The losses on any given mortgage portfolio are concentrated in a relatively few years. This conclusion is supported by the major studies of losses experience on mortgage portfolios.[6]

The reasons for this intense concentration of loss reside in the peculiarities and characteristics of real estate. Failure to deduct a portion of the interest income derived from a mortgage portfolio as a needed valuation reserve therefor can only result in an overstatement of income and the exposures of savings and loans to an under-reserved position.

The need for such a valuation reserve for our institutions does not depend upon the recurrence of another 1930. It is not necessary to experience a price decline of 30 percent to produce losses in a mortgage portfolio today. As of December 31, 1961, 5½ percent of all loans held by savings and loan associations have been on the books for less than 3 years and more than 37 percent are less than 2 years' old.[7]

Moreover, the average loan amount has more than doubled in the past 10 years, and, indeed, has increased substantially more rapidly than had the average purchase price. In 1950 the average loan made by insured savings and loan associations to finance single-family homes was 58.4 percent of the purchase price.[8]

In 1961 it was almost 70 percent. Almost 43 percent of the loans made by insured savings and loan associations in 1961 were for more than 75 percent of the purchase price. Foreclosures in 1961 were more than twice the number in 1957. Mr. Chairman, I would like to submit for the record the latest report of the Federal Home Loan Bank Board on "Nonfarm Real Estate Foreclosures" dated March 1962, if I may. The date is March 22, 1962.

The CHAIRMAN. Without objection the insertion will be made.

(The document referred to follows:)

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[6] Dr. John Lintner, "Mutual Savings Banks in the Savings and Mortgage Markets," Harvard University Press. Dr. Raymond Goldsmith, "A Study of Savings in the United States," Princeton University Press. "Studies of Mortgage Losses by Major Institutional Leaders," of the National Bureau of Economic Research.

[7] Based on data tabulated annually by the Division of Supervision, FHLBB.

[8] Ibid.

FEDERAL HOME LOAN BANK BOARD

WASHINGTON 25, D.C.

NONFARM REAL ESTATE FORECLOSURE REPORT, YEAR 1961

For the year 1961, foreclosures on nonfarm real estate are estimated at 73,074 as compared with 51,353 such actions in 1960. Following a 7-year gradual rise in the number of distress actions taken, a definite upswing occurred starting about midyear 1960 and reaching the greatest intensity in the first and second quarters of 1961, when rises of 50 percent over the previous year were recorded. Despite these and successively smaller increases for the remainder of 1961, the current level of distress actions is still low when considered in light of the unprecedented level of total home mortgage debt and financing activity during the past decade.

Estimated number of nonfarm foreclosures

	1st quarter	2d quarter	3d quarter	4th quarter	Total
Year:					
1935	60,924	62,499	54,207	51,083	228,713
1940	18,695	20,173	18,746	17,942	75,556
1945	3,424	3,402	2,893	2,987	12,706
1950	5,523	5,758	5,257	4,999	21,537
1955	7,089	7,765	6,757	6,918	28,529
1959	11,041	11,663	10,683	10,688	44,075
1960	11,245	12,433	13,450	14,225	51,353
1961	16,891	18,608	18,508	19,067	73,074
Percent change:					
1940–61	−10	−8	−1	+6	−3
1960–61	+50	+50	+38	+34	+42

NOTE.—In the fourth quarter of last year nonfarm foreclosures numbered 19,067—34 percent above the same period in 1960 and 6 percent above the closing quarter of 1940.

Source: Operating Analysis Division, March 1962.

Estimated nonfarm real estate foreclosures, 1926–61

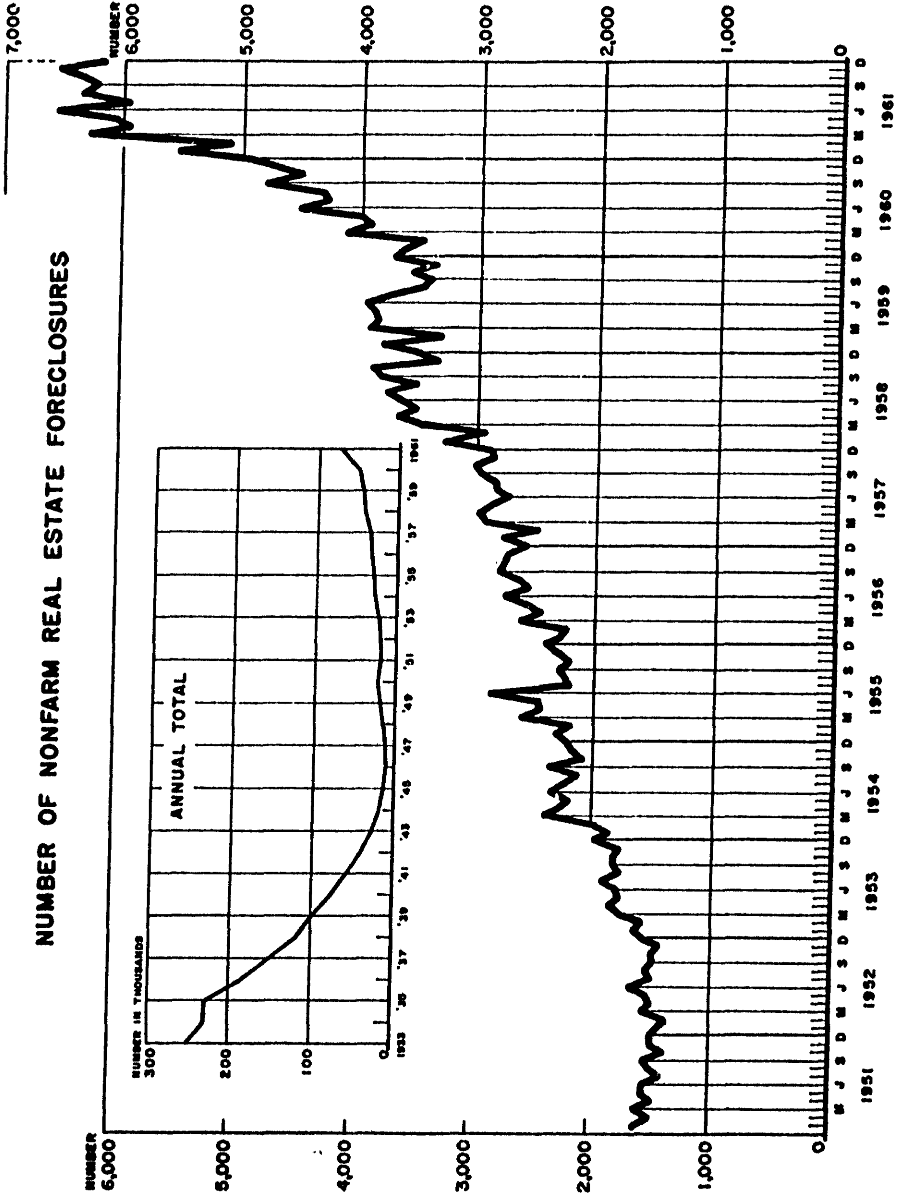
ANNUAL TOTALS

Year	Number	Year	Number	Year	Number
1926	68,100	1936	185,439	1946	10,453
1927	91,000	1937	151,366	1947	10,559
1928	116,000	1938	118,357	1948	13,052
1929	134,900	1939	100,410	1949	17,635
1930	150,000	1940	75,556	1950	21,537
1931	193,800	1941	58,559	1951	18,141
1932	248,700	1942	41,997	1952	18,135
1933	252,400	1943	25,281	1953	21,473
1934	230,350	1944	17,153	1954	26,211
1935	228,713	1945	12,706	1955	28,529

MONTHLY DATA

	1956	1957	1958	1959	1960	1961
Total	30,963	34,204	42,367	44,075	51,353	73,074
January	2,288	2,771	3,276	3,801	3,630	5,523
February	2,238	2,475	2,929	3,307	3,470	5,096
March	2,615	2,921	3,477	3,938	4,145	6,272
April	2,472	2,983	3,661	3,841	3,918	5,942
May	2,559	2,894	3,507	3,876	4,001	6,090
June	2,755	2,745	3,663	3,946	4,514	6,576
July	2,548	2,839	3,774	3,768	4,289	5,946
August	2,618	2,852	3,518	3,494	4,347	6,348
September	2,802	2,979	3,820	3,421	4,814	6,214
October	2,762	3,018	3,881	3,583	4,512	6,352
November	2,737	2,852	3,339	3,378	4,740	6,564
December	2,569	2,877	3,522	3,727	4,973	6,151

NOTE.—Estimates of number of foreclosures in the United States (except Alaska and Hawaii) in all nonfarm areas are based on data reported from approximately 1,700 counties, cities, townships, or other government divisions, and measure the number of properties acquired through foreclosure proceedings. Reporting areas include approximately three-fifths of all nonfarm one- to four-family dwelling units. Voluntary deeds of sale in lieu of foreclosure are not included, nor are defaults on real estate contracts.


NUMBER OF NONFARM REAL ESTATE FORECLOSURES
ANNUAL TOTAL
NUMBER IN THOUSANDS
NUMBER
7,000
6,000
5,000
4,000
3,000
2,000
1,000
0
300
200
100
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

Mr. KREUTZ. There is neither time nor necessity to detail for this committee the importance of housing to social stability, moderation of economic fluctuations, and sound economic growth. Everywhere in the world today housing is a major concern of governments. There are obviously many elements required for a strong, sustained volume of residential construction and private homeownership. One of the most important of these elements is a private financial system, the lendable funds of which are confined to the credit needs of the housing sector of the economy. Savings and loan associations alone among all the various parts of this Nation's financial structure are exclusively confined to the credit needs of the housing section. In this they are unlike any of the other financial intermediaries and particularly unlike the commercial banking system.

We are special purpose institutions. In fact, we were so created by the Congress. Had we not been created to mobilize private savings and to channel those savings to fulfill the housing needs of this country, the pressure on the Federal budget would have been gigantic. Even with the savings and loan business lending $12 to $15 billion a year, there have been substantial commitments of Federal funds to meet certain specified areas of housing need. If there had not been a savings and loan business, how much greater would the commitment of Federal funds have had to be.

The savings and loan business today is currently supplying over 60 percent of the net increase in one- to four-family home mortgage debt.[9]

This is not the record of a single economic year. It is the result of a continuous record of performance. During this same period, the commercial banks have failed to extend credit in anything approaching this volume or anything comparable to the terms required by the home mortgage market.

The very capacity of the commercial banking system of this Nation to invest in a wide variety of types of loans and securities has resulted in these commercial banks following the marketplace in the allocation of their lendable funds. In 1960, for example, the last year for which complete data is available, the commercial banking system actually decreased its total residential mortgage holdings by approximately $57 million, despite an increase in savings and time deposits of $5.8 billion, and an increase in net aftertax profits in excess of $0.5 billion.[10]

In this same year, the savings and loan associations had a net increase of savings of $7.4 billion and invested $7 billion of that increase in the home mortgage market.[11]

The commercial banks' campaign under the slogan of "tax equality" has as its principal objective a massive diversion of savings to the commercial banking system. They know that changes in the relationship between interest rates paid on savings by commercial banks and savings and loan associations result in dramatic shifts in the flow of savings. They know and have frankly admitted that the imposition of additional corporate taxes on our institutions is going to narrow

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[9] "1960 Source Book," FHLBB.
[10] 1960 Annual Report, FDIC.
[11] "1961 Source Book, FHLBB," and "1961 Savings and Home Financing Chart Book, No. 6."

the differential paid savers. Indeed, this is the principal thrust of their position.

Last year the Treasury asked the Housing and Home Finance Agency to comment on this differential and its relationship to the level of homebuilding and interest rates. Dr. H. B. Schecter, an economist for the Agency, presented a scholarly and objective analysis of the problem. His conclusion was:

The most significant evidence with regard to the effect of a reduction in the interest rate paid by mutual thrift associations relative to that paid by commercial savings banks is the 1957 experience, when there was a significant change in the spread between the commercial banks' and the mutual thrift institutions' interest rates, the 1957 experience suggests that a reduction of one-fourth of 1 percentage point in the interest rate paid on savings by mutual thrift associations, without a reduction in the commercial bank interest rates paid on savings, could result in a shift of the more than one-fifth of the net savings inflow from the mutual thrift institutions into the commercial banks. The amount would be about $3 billion, equal to about 25 to 30 percent of current annual net mortgage requirements.

Furthermore, based on past experience, such a shift would tend to make for a tight mortgage market and a reduced level of homebuilding. Since the available data indicate a positive relationship between changes in the proporton of institutional savings going into the mutual thrift associations and changes in the level of new homebuilding.

The action of the Federal Reserve Board earlier this year had the effect of increasing the interest rate on savings deposits and has already narrowed or eliminated the rate differential. This tax bill may wipe out the spread completely. This is the commercial bankers' stated objective. This may seem to them to be a legitimate competitive objective, despite their own unique and substantial tax advantages. We suggest, however, that tax policy must be based upon broader foundation.

Section 19 of the House bill establishes a withholding system on interest and dividends. This proposal obviously complicates the position of the thrift institutions even more in the years that are ahead. Aside from the burden of bookkeeping, the costs of which must be borne by us, 90 percent of the total return paid to savers in our institutions are credited to the accounts of those savers rather than disbursed to them in cash payments. This is a substantial amount of money. Crediting of interest or dividends on savings accounts in our institutions represents an increase in our lendable funds each year by more than $2.7 billion.

We have diligently worked in cooperation with the U.S. Treasury, urging our savers to report fully such income. Normally, the individual savings account taxpayer, paying taxes on such interest or dividends, prudently does not touch his savings funds to pay those taxes. He retains the earnings as an addition to his savings account and meets his taxpayments out of other funds.

The imposition of withholding, therefore, in practical effect, will cut the dollar volume of retained earnings by the proposed 20-percent rate. It will require our institutions to do that which the individual saver does not do, namely, withdraw the funds from our institutions and consequently the home mortgage market. This will obviously reduce our lendable funds by approximately one-half billion dollars a year. Parenthetically, we wonder if we are going to be required to deposit those funds in the tax and loan accounts of commercial banks, which, as the members of this committee well know, is not without substantial advantage to the commercial banking system.

The spokesmen for commercial banks have repeatedly asserted in recent months that they are ready, anxious, and willing to meet the credit demands of American families for homeownership. They have repeatedly stated that, regardless of the record of their business over several decades in this area of national need, things are going to be different in the future. They have had the opportunity in the past months. The Federal Reserve Board has granted them permission to increase the return paid to savers; and as a system, they have taken advantage of that opportunity. Since the increases were made on January 1 of this year, the commercial banking system has been receiving the bulk of the private savings of the country. Yet, what have they done with those savings in terms of investments Has there been a rapid and massive upsurge in commercial banks' investment in residential mortgages? Have they followed their promises of performance with performance?

Federal Reserve reports of weekly reporting member banks in leading cities show that from yearend 1961 through March 28, 1962, these banks have committed only $200 million to all types of mortgages, residential, industrial, and commercial, a figure which represents only 5.8 percent of the $3.6 billion increase in time and savings deposits.[12] In the same period they have increased their purchase of tax-exempt securities of State and municipalities about $1 billion.[13]

It is not our position that purchase by the commercial banking system of tax-exempt securities is improper. Such purchases are a natural investment response by a commercial banking system to an increase in savings flow. If the commercial bankers are successful in their program of so-called tax equality between totally dissimilar investment and after-tax profit possibilities, they will succeed in diverting at least $3 billion out of savings and loan associations into commercial banks. The bulk of the savings so diverted will not find its way back into the home mortgage business. The removal of a substantial portion of this $3 billion from the home mortgage credit needs of the average American family can only result in one thing: substantial increases in the rates of interest paid by the average American family to acquire the average American home. This process can only result in renewed and intense pressure upon the limited resources of the Federal Government to aid home construction directly.

A. PERIOD OF ADJUSTMENT TO INCREASED TAXATION

The savings and loan business does not oppose corporate taxes on corporate net income. The debate has rather centered on the issue of whether allocations to loss reserves by savings and loan associations were in fact corporate net income. Our basic position has always been that a part of each interest payment received on each loan is not net income but must be set aside to cover reasonably anticipated losses.

However, the Ways and Means Committee proposed and the House of Representatives passed a tax bill containing certain specific provisions respecting allocations to loss reserves by our institutions. We have diligently and objectively sought to apply the provisions of

[12] Federal Reserve statistical releases, series H.4.2.
[13] Estimate, derived from ibid.

section 8 to savings and loan associations. The impact of the House proposals will be severe and immediate on all institutions, but the extent of the impact will vary widely from one institution to another. Our type of financial institution, almost all of whose assets are committed to long-term real estate loans, does not possess the inherent ability or capacity to adjust promptly to such a drastic increase in its cost of operations. All associations, beginning in 1963 under the provisions of the House bill, would face substantial increases in costs. Their ability to pay a competitive return on savings would be correspondingly reduced which in turn would markedly reduce the flow of savings into the home mortgage lending field.

In many instances, the impact of the provisions of the House bill would be extremely severe. Approximately 10 percent of our associations would be compelled to reduce the return paid to their savers below the rate currently paid by most commercial banks. Certainly a single-purpose financial institution possessing none of the specialized economic and tax privileges available to commercial banking, would be unable to compete under such circumstances with the total range of services offered by commercial banks. Indeed, conversion of these thrift institutions to commercial banks might be a most appealing prospect.

It is for these reasons that we most respectfully urge this committee to give serious consideration to increasing the allowable deduction of 60 percent of income in the House bill to 75 percent, or at the very least, to provide a 3- or 4-year transition period in which we can adjust our operations to the impact of the proposed taxation.

B. DEFINITION OF SAVINGS AND LOAN ASSOCIATIONS

By section 5 of the Home Owners' Loan Act of 1933, Congress authorized the establishment of Federal savings and loan associations and provided for their regulation and control. The following year it enacted the National Housing Act. Title IV of that act created the Federal Savings and Loan Insurance Corporation and authorized it to insure the accounts of all federally chartered associations and all State-chartered associations which meet the exacting standards established by the act.

Federal associations are under the exclusive supervision of the Federal Home Loan Bank Board and State-chartered insured associations are subject to examination and supervision in cooperation with State authorities. We think, therefore, that these insured institutions should be included within the class of taxpayers to which section 593 applies without further limitations such as those contained in this bill. Such is the case with other institutions to which the section applies.

There is a long history of governmental concern for financial institutions. They recive certain special benefits and are subject to certain special restraints. In our Nation we have a wide variety of types of financial institutions needing different and specialized credit requirements. Each of these classes of institution performs a valued and important service. Each, however, is different and functions in a manner unique to itself. Those who would obscure or eliminate these differences for the sake of competitive advantage in a particular narrow aspect of their operations do not serve the interest of the

financial community or of the wider community which these institutions are created to serve.

We have no quarrel with the commercial banking system. We feel this Nation is well served by it. Our position basically is that we are different. We do not possess its advantages. We do not serve the same primary needs which it was created to serve. We rest our case on the kind of business we do, the risks inherent in that business, and the limitations which are imposed upon us.

Thank you.

The CHAIRMAN. You state that at the end of last year—

> Commercial banks held an additional $66.5 billion in U.S. Government securities which are subject to a specialized tax treatment not available to the ordinary corporate taxpayer.

Would you explain that, please?

Mr. KREUTZ. Yes; sir; I would be glad to try.

The tax treatment is that these institutions can expense their losses on these securities when they are sold at a loss, and pay a capital gains tax on the profits when there are profits, and that represents a very substantial advantage to the commercial banking system.

The CHAIRMAN. Doesn't the ordinary person pay a capital gains tax on a profit?

Mr. KREUTZ. I think not, sir—an ordinary individual?

The CHAIRMAN. Yes, sir. They pay if there is a profit involved when they sell?

Mr. KREUTZ. Yes, sir; financial institutions do.

The CHAIRMAN. They pay a capital gains tax.

Mr. KREUTZ. Yes, sir.

The CHAIRMAN. It is not exactly clear to me the difference here. Can you repeat it? What is the difference between the taxation of the banks, as you have stated, that they are subject to specialized tax treatment not available to the ordinary corporate taxpayer?

Mr. KREUTZ. Yes, sir. The ordinary corporate taxpayer does not have that advantage, sir; a commercial bank does.

The CHAIRMAN. Repeat it over again.

Mr. KREUTZ. I say the ordinary corporate taxpayer does not have that advantage.

The CHAIRMAN. What advantage?

Mr. KREUTZ. Of paying a capital gains tax at a 25-percent rate on the profit realized from the sale of a security, and of expensing any loss which may be experienced on the other hand in the sale of the security.

The CHAIRMAN. Expensing a loss?

Mr. KREUTZ. Yes, sir.

The CHAIRMAN. By the sale of securities?

Mr. KREUTZ. Yes, sir.

The CHAIRMAN. Of course, you can have a capital gains tax, anybody can have that tax, if they have a profit, can they not?

Mr. KREUTZ. Yes, sir; but only——

The CHAIRMAN. Then you say the banks, if they have a loss on the sale of securities, can put that in ordinary income, is that what it is?

Mr. KREUTZ. They charge that as an expense against ordinary income; yes, sir; and that is a distinct advantage to them because the effect of it is that they can sell a security at a loss, let us say.

The CHAIRMAN. The staff says the savings and loan could get the same tax treatment.

Mr. KREUTZ. Yes, sir; we can; but we do not deal in Government securities like commercial banks do. We do not trade in securities. We are required by the statute to maintain a certain amount of liquidity. The Federal Home Loan Bank Act says from 4 to 8 percent and the Federal Home Loan Bank Board regulations fixed that at 7 percent, and so we have to take part of the receipts from our savers and put them into Government bonds. That is the only thing we can put it into other than cash under our statute, and we have put it in there and we leave it there mostly. We do not have the advantage of having large amounts of demand deposits on which we pay no interest, and it is with that kind of deposits that the banks are able to obtain a very distinct advantage.

As a matter of fact, Mr. Chairman, we would not object at all, and I can make this statement based on the fact that we do not use the device to any appreciable extent, and we would not object if that feature were eliminated so that neither the commercial banks or the savings and loans were given that privilege.

The CHAIRMAN. I would like the staff to make a statement as to whether there is any difference in the treatment between savings and loans and the banks with respect to Government securities. Is there any difference in the treatment between the savings and loans and the banks?

Mr. STAM. I do not think there is in the tax law. In the tax law, I mean, this provision you were talking about, would apply to both. If you say the savings and loans do not deal in those securities, they could, and so the tax law applies equally to both.

Mr. KREUTZ. Yes, sir; I agree with that.

The CHAIRMAN. Well, the impression you gave——

Mr. KREUTZ. But we are not in a position to take advantage of it.

The CHAIRMAN. The impression you gave was it is subject to a specialized tax treatment not available to the ordinary corporate taxpayer. That is not correct, is it?

Mr. KREUTZ. The corporate taxpayer would not expense the loss and take a capital gain.

The CHAIRMAN. Is this statement that the witness made—I have no doubt he thought it was correct—but is it correct?

Mr. STAM. Well, the banks and the savings and loan groups both get this treatment, and that particular treatment is not available to the ordinary corporate taxpayer, but it is available—I am talking about as a matter of law here it is available—to both the savings and loan and the banks.

Mr. KREUTZ. Yes, sir; and that is what I was trying to say, exactly.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Well, Mr. Kreutz, as I understand your testimony or your statement here today, you are not opposing additional taxes on the savings and loans. You do make some suggested amendments to the House provisions.

Mr. KREUTZ. Let me say we are resigned to the inevitable, Senator.

Senator CARLSON. I noticed that one of the features you mentioned was a transition period of 3 or 4 years.

Mr. KREUTZ. Yes, sir.

Senator CARLSON. Do you think the period in the present House bill is too short?

Mr. KREUTZ. There is no transition period in the present House bill except that it would be effective the 1st of January 1963; and we know a very large number of institutions would b[illegible]ery hard hit by the sudden impact of this on the 1963 operations.

Therefore, we do urgently recommend that th[illegible] be a transition period to help them get their houses in order, an[illegible] be a little better prepared to meet the shock of this thing.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. I understand that the House bill contains a provision which would repeal the exemption from excise taxes on transportation and communications that have been available to federally chartered savings and loan associations. I understand, however, there are still other excise taxes from which all building and loan associations are exempt, namely the documentary stamps imposed on the issuance of the transfer of stocks and bonds by section 403(1)(f)(7), and on conveyances of real estate; is this true?

Mr. CURRY. Senator, I believe there is a section in the code with respect to stock transfers. I might say this. We have no objection to removing the exemption on stock transfers.

Mr. KREUTZ. I was not aware the exemption existed.

The CHAIRMAN. The information came from the staff. Thank you. Are there any further questions? If not, thank you very much, sir.

Mr. KREUTZ. Thank you.

The CHAIRMAN. I appreciate your testimony.

Mr. KREUTZ. Thank you, sir.

The CHAIRMAN. Our next witness is Alfred S. Mills of the National Association of Mutual Savings Banks. Mr. Mills, take a seat, sir.

STATEMENT OF ALFRED S. MILLS, TREASURER, NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS; ACCOMPANIED BY GROVER ENSLEY, EXECUTIVE VICE PRESIDENT; AND JOHN T. SAPIENZA, TAX CONSULTANT

Mr. MILLS. Mr. Chairman and members of the committee, my name is Alfred S. Mills, and I am president of the Bank for Savings in New York City, and treasurer of the National Association of Mutual Savings Banks.

I appear on behalf of the Association of Mutual Savings Banks with respect to section 8 of the proposed Revenue Act of 1962. Our announced witness, Edward P. Clark, whose name is shown on the prepared statement before you, was taken ill during the night, and I am making the presentation for him.

I have with me Dr. Grover Ensley, executive vice president of the national association, and John T. Sapienza, tax consultant of the national association.

The National Association of Mutual Savings Banks represents substantially all of the country's mutual savings banks, more than 500 in number located in 18 States, holding about $39 billion in savings deposits in 23 million accounts.

In brief, our position is that the present law taxing mutual savings banks is fair in the light of their long history of service to the small

saver and the homeowner. These institutions pass on all earnings to depositors except necessary reserves for losses. If now the Congress concludes these institutions should pay more tax at the corporate level, we urge this committee to accept section 8 of the bill passed by the House of Representatives, with three modifications to reduce its adverse impact on savings depositors and housing:

(1) Provide a transition period of 3 years to the full tax.

(2) Increase the loss reserve for real estate loans from 3 to 3½ percent.

(3) Allow deduction of 3½ percent of the net increase in loans in any taxable year instead of the amount necessary to increase the reserve to 3½ percent of loans outstanding at the end of the year.

Mutual savings banks have no stockholders. Their sole functions are to encourage individual thrift, accept savings deposits and channel these savings into productive investments, particularly home mortgages. For nearly 150 years they have been the safest and most popular savings facility for medium and lower income families in the areas where they exist.

The Chairman might be interested in the fact that in my State of New York there has not been a savings bank failure in more than 50 years, and you will recall that takes you back through the depression and two great wars. We are very proud of this record of safety.

Mutual savings banks provide savings facilities and promote thrift year in and year out, rather than only when considered profitable as with commercial banks. It has long been public policy, both State and Federal, to require that these institutions be operated soundly, and to require and encourage the accumulation by each institution of adequate reserves against losses to protect the savings of the depositors.

The importance of mutual savings banking in providing home mortgage credit has become in recent years perhaps as essential as its role in providing safe and convenient savings facilities. Of the total increase in savings bank assets of $26 billion during the period 1946–61, 95 percent has been invested in mortgages. While oriented to meeting the mortgage credit needs of their local communities, savings banks, which, I must remind you, are only in 18 States, hold about $7 billion in mortgages on properties located in nonsavings bank States, mainly in rapidly growing areas of the West, Southwest, and South. Mutual savings banks have over two-thirds of their total assets in mortgages today and the percentage is increasing. In contrast, commercial banks, due to their concentration in more profitable short-term lending activity, have only one-ninth of their assets in mortgages. In 1960, when their time and savings deposits increased by $4 billion, they increased their holdings of residential mortgages by only $42 million.

In recognition of their mutual form of organization and the basic fact that the burden of a tax on a mutual savings institution must necessarily fall completely on the savings depositor, mutual savings banks were exempt from Federal income taxation until 1951. During this period there was little or no complaint from commercial banks about discrimination or lack of so-called tax equality. In 1951, there was an expanded need for revenue to finance the Korean war. At that time the Congress decided that mutual savings banks should be taxed on the earnings retained in excess of those it deemed to be a reasonable reserve against losses for the protection of depositors.

We have regarded the approach which Congress adopted in 1951 as sound and equitable. Earnings retained solely for the safety of depositors should not be taxed as corporate income. In most States such earnings are required by law or supervisory regulation to be so retained. They do not result in practice in realizable appreciation in the depositors' investment. If such retained earnings are taxed, however, it is important that a proper allowance be made for accumulation of adequate reserves. We believe that the present law makes such a proper reserve allowance. Except for amounts added to protective reserves, all earnings after expenses are paid as interest which is taxable in the hands of depositors. With an appropriate reserve provision savings banks will continue to grow and to generate a substantial and rising amount of income tax revenue from individuals.

The House, however, has now concluded that to produce more revenue at the corporate level, the present law should be amended to reduce the rate at which additions may be made to reserves for bad debts. The present law permits transfer of all taxable income to a reserve for bad debts until total surplus, undivided profits and reserves amount to 12 percent of deposits. Essentially the House bill authorizes transfer of 60 percent of taxable income to such a reserve. As an alternative it permits transfer of amounts which would bring such a reserve to 3 percent of loans.

In proposing these changes in the law, the House rightly refused to make the bad debt reserve provision for mutual savings institutions conform to that of commercial banks. The commercial banks have been given a unique bad debt reserve allowance in recognition of their special character as short-term commercial lending institutions. The provision has long ben condemned by commercial banks as inadequate. Commercial bank organizations have argued in the past for a statutory bad debt reserve as high as 10 percent of qualifying loans, and I might say if the commercial banks can prove this need, I am sure that we would not quarrel with the increase in their bad debt reserve position.

With the impression that promoting thrift can be profitable to stockholders under present economic conditions, commercial banks have recently launched an aggressive campaign to increase their saving deposits. Unable to convince the Government of the merits of increasing their tax-free reserves, they have sought to handicap their competitors through heavier taxation.

Their arguments for so-called tax equality fail to recognize basic differences between the mutual savings banks and commercial banks. Many observers familiar with financial institutions, including the National Association of Supervisors of State Banks, have noted such basic differences.

Arguments for so-called equality ignore certain basic facts:

1. One cannot compare total taxes paid by commercial banks with total taxes paid by savings institutions. There is good reason to believe that the savings end of the commercial bank business originates little or no taxable income. Rather, profits of commercial banks and hence corporate income tax liabilities arise primarily from their money creation or demand deposit activities or such other things as their very great trust department activities, things of this character that savings banks cannot take part in. Comparisons of tax paid

which do not segregate figures for the savings operations from commercial operations are therefore irrelevant. If you will bear with me, I can think of a bank in New York which has deposits of about $200 million. They have a trust department which handed about $6 billion of trusts. Obviously such bank is paying a high income tax, but it is not in any way related to their savings experience.

The commercial banks have been careful to avoid showing such a segregation on an industrywide basis.

2. A commercial bank which retains earnings to increase the value of its stockholders' equity will normally have more taxable income than a regulated investment company or a mutual savings institution which acts basically as a conduit. I do not need to elaborate, I am sure with this committee, on what we mean by the conduit theory. As we have pointed out mutual savings banks pay out all earnings other than necessary reserves to depositors in whose hands they are taxable.

3. Commercial banks have enjoyed record prosperity in recent years; profits after taxes of insured commercial banks grew by 121 percent from $908 million in 1951 to an all time high of $2 billion in 1960. Since 1950, time and savings deposits of commercial banks have increased by 116 percent, a more rapid rise than the 91-percent increase in savings bank deposits.

I was startled to hear the other day that two of the largest commercial banks in New York City where my institution is located have been gaining savings deposits at the rate of $1 million a day each, since the first of January.

The market value of commercial bank stocks, as measured by indexes published by the Survey of Current Business of the Department of Commerce, increased by more than 160 percent since 1950.

4. Investments of commercial banks and savings banks and hence their loss reserve needs are very different. Commercial banks invest typically in a wide range of short-term business loans, the volume of which can be readily adjusted for cyclical change. Mutual savings institutions concentrate their investments in long-term mortgage loans, one of the most nonliquid of all forms of investment. The long history of savings banking, which goes back 144 years, proves the wisdom of supervisory authorities and bank trustees in requiring the accumulation of reserves adequate to protect depositors from losses.

Losses on mortgage loans tend to be concentrated in a few years of the business cycle. Foreclosures by Massachusetts savings banks during the 4 years 1932–35 amounted to 19.7 percent of mortgages outstanding at the beginning of the period. Realization on the foreclosed property in the ensuing 15 years recouped part of the loss, but the ability to hold the foreclosed homes instead of liquidating them quickly in a depressed market largely resulted from the banks' strong reserve positions. Ample provision must be made in advance to absorb losses and such provision in the case of mutual savings banks can be made only out of income. There is no other source.

In an exhaustive study of mortgage losses of Massachusetts mutual savings banks published in 1949, "Mutual Savings Banks in the Savings and Mortgage Markets," Dr. John Lintner of Harvard University found that losses of the banks in the years 1931–45 were 17.4 percent of average portfolio during the period and 14.3 percent of the gross mortgage portfolio at the end of 1930. These figures were typical of

other States. They are averages and the experience of numerous individual banks was, of course, worse.

In addition to the effects of heavier taxation on the ability of mutual savings banks to accumulate adequate reserves for losses, a basic consideration is the effect on the housing activity of the Nation. The Housing and Home Finance Agency, the Federal Home Loan Bank Board, and the Veterans' Administration warned last summer as to the adverse consequences on housing credit if proposals then put forward should become law. The Housing and Home Finance Agency foresaw a possible decline of 100,000 to 135,000 units in housing starts annually.

The Treasury staff report of last year noted that—

any change in the tax treatment of the mutual thrift institutions, which invest the great majority of their funds in residential mortgages, must be weighed in the light of its possible effect on these (housing) programs.

President Kennedy indicated in his special housing message of March 9, 1961, that—

residential construction alone accounts for 30 percent of total private investment in this country. The housing market absorbs more private credit than any other single sector of the economy. Other important industries and services, including those concerned with building materials, appliances, furniture, and home improvement, depend largely and directly on new housing construction.

The House properly showed concern for both the risks to which savings banks are subject and the housing needs of the Nation in providing alternative ways of computing deductible additions to bad debt reserves. The report of the Ways and Means Committee states that—

the bill provides reserves consistent with the proper protection of the institution and its [depositors] in the light of the peculiar risks of long-term lending on residential real estate which is the principal function of these institutions.

Most of our institutions will probably compute their deduction under the 60-percent-of-income limitation. The law of New York requires mutual savings banks to set aside a portion of earnings each year as a reserve for losses, until total earnings so set aside reach 10 percent of deposits. This is based on book values, and 10 percent on that basis is equivalent to approximately 11 or 12 percent of the basis used by tax authorities to arrive at our surplus. There are comparable requirements in most other savings bank States. Since interest rates to depositors must remain competitive, some institutions can meet their statutory reserve requirements, and by that we mean our State reserve requirements, only by transferring all their taxable income to such reserves, and must pay the rest to depositors. If, to provide additional revenue at the corporate level, the deduction of 100 percent of taxable income is no longer permitted, it is probable that many of these institutions must reduce their interest rates, which will discourage deposit inflow, or indeed induce deposit outflow. I do not need to say we are stating unequivocally that all savings banks will have to reduce their rates. It seems this is only a natural outcome unless they can by some other means offset this effect.

In either event, whether the deposit inflow is discouraged or actually reduced, their ability to serve their communities and the Nation will be greatly impaired. The impact will fall on nonsavings-bank States, where savings banks today hold about $7 billion in home mortgages. It is clear that savings banks must devote their reduced funds first to

satisfying the needs of their own communities, the 18 States they are actually located in.

Turning now to the other alternative provided in the bill, we note that the Secretary, in his testimony on section 8 last week before this committee, approved—

allowing these institutions to deduct * * * 3 percent of net additions to real estate loans.

It is unfortunate that the Ways and Means Committee receded from its tentative decision to allow a loss reserve deduction of 3½ percent of loan increase. This was touched on in testimony this morning, I think. Such a reserve would permit the newer institutions and the ones that are trying to expand their mortgage accounts to do a better job.

Originally it proposed to allow each institution to deduct 3½ percent of its net increase in loans during the taxable year. Later it announced it was reducing the figure to "3 percent of the increase during the year on loans on improved real estate." But I emphasize the difference there, 3 percent of the increase during the year in loans. However, section 8 of the bill before us provides instead for a deduction of the amount "necessary to increase the balance * * * of the reserve * * * to 3 percent" of loans outstanding at the close of the year. There is a very distinct difference there. We propose revising the bill to correspond with the announcement of the Ways and Means Committee and the description of the alternative by the Secretary of the Treasury before this committee. To provide incentive to more plentiful home mortgage credit, the right to a deduction based on net loan increase should be available each year.

A bad debt reserve allowance based on loans or loan growth as an alternative to an allowance based on income will permit new and other savings institutions to build a minimum bad debt reserve against loan losses more rapidly than would otherwise be possible. It will afford an incentive to institutions which have a relatively small proportion of their assets in home loans to expand their holdings of these riskier investments faster than would otherwise be possible.

As we see it, 3½ percent of the increase in loans on improved real property will exceed the alternative deduction of 60 percent of an institution's taxable income when two conditions obtain: (*a*) tremendous demand for housing and mortgage credit, as expected in the later sixties, or (*b*) decline in investment income during a period of recession when it may be particularly desirable to encourage easier mortgage credit to stimulate housing construction and employment.

In urging that the proposed reserve based on loans be increased to 3½ percent and modified to permit an effective annual alternative for 60 percent of income, we do not mean to suggest a preference between the two. We believe both alternatives are necessary to permit these institutions to perform their historic functions.

Finally, it is unfortunate that the Ways and Means Committee abandoned its original decision to permit a period of transition to the new basis of taxation. Under the transition originally provided, the tax otherwise payable in the first year would have been reduced by 50 percent, in the second by 33⅓ percent, and in the third by 16⅔ percent. As evidenced by the heavy withdrawals which savings institutions experienced in October 1959 when the Treasury offered 5-per-

cent obligations of less than 5 years maturity, depositors are highly sensitive to relative return. The new tax imposed by this bill comes at a time when commercial banks have been encouraged by the Federal Reserve Board's increase in interest rate ceilings to bid aggressively for savings deposits, and is coupled with a 20-percent withholding at source on interest as it is proposed before your committee. To permit as much time as possible for savings institutions and depositors to adjust to the new conditions, it would be desirable for the Senate to restore the transition provisions.

To summarize the views of mutual savings banking we believe that if the Congress finds it necessary to tax these institutions more heavily, the general approach of section 8 of the bill as passed by the House is appropriate. It will, we believe, inevitably have the tendency, however, to lessen the effectiveness of these institutions in promoting thrift and providing housing credit. We urge that the general structure of this section of the bill passed by the House be preserved, including in all events the right to elect to deduct for loss reserves at least 60 percent of taxable income, but strongly request that is adverse impact on savings depositors and housing be reduced by:

(1) Postponing the full impact by a transition period of 3 years;
(2) Increasing the loss reserve of 3 percent to 3½ percent; and
(3) Allowing the deduction of 3½ percent of the net increase in loans in any taxable year rather than the amount necessary to increase the reserve to 3½ percent of the loans outstanding at the end of the year.

Mr. Chairman and Senator Carlson, we appreciate this opportunity to present our views to you, and we thank you for permitting us to do so.

The CHAIRMAN. Thank you very much, Mr. Mills.

Senator Carlson.

Senator CARLSON. Mr. Mills, just one or two questions. I am familiar with the commercial banking institutions in our State, the savings and loans. Do we have insured savings banks or mutual savings banks in Kansas? Is that 1 of the 18 States?

Mr. MILLS. No, sir. To our profound sorrow it is not one of the 18 States. In fact, it is subject to great regret that only four of the members of the Finance Committee are from the 18 States.

Senator CARLSON. That is very interesting, I can assure you. I had not recognized that we had any in our State, but I was not sure.

Mr. MILLS. No, sir.

Senator CARLSON. Are you familiar with the section of the bill as passed by the House?

Mr. MILLS. I believe so, sir.

Senator CARLSON. I got this from the staff and it is a good question. On page 53 of the bill there is a new rule for determining the tax consequences of mortgage foreclosures by building and loan associations and mutual savings banks. What is the reason for this rule? Can you give us the information on that?

Mr. MILLS. I believe I am correct, this is a change in the method of computing our loss. Can I make sure I am following the right paragraph?

Yes; in many States the amount paid at a foreclosure sale no longer has any connection with the value of the property. In some States

the institution is required to bid the amount of the mortgage, at least; in other States a nominal bid can be made, and that is sometimes done to save the tax on the sale.

This provision is an attempt to make sure that the true loss has been established, the property has been foreclosed and resold, and at that time the institution will really know what loss it has experienced; am I right, Mr. Sapienza?

Senator CARLSON. Is there any reason why this should be limited to these two institutions, that particular section?

Mr. MILLS. I do not think so. Do you?

Mr. SAPIENZA. Senator, I think there is a historical reason for this. The 1954 code would have applied a similar rule across the board. There was great objection from other people engaged in the same type of transaction.

We think this rule would be a very salutary rule. It avoids the quixotic results that occur when you have the rule that the bad debt loss occurs on the basis of the bid, and there may be a capital gain or loss at that time, and then when the property is sold you have a new basis, and you have a loss which may be capital or ordinary at that time.

We thought it would be better to have this treated as a collection process under which the loss would be a bad debt loss determined at the end of the collection process.

Senator CARLSON. Thank you very much. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Mills, I have a question prepared by the staff. Doesn't the bill grant a windfall to an old established institution which has a very large surplus accumulated prior to 1952 because the bill completely ignores this pre-1952 surplus in splitting up the existing reserves for purposes of a future tax deduction?

For example, an institution might have a pre-1952 surplus equal to 12 percent of deposits and have no reserves accumulated since 1951 because existing law takes into account the pre-1952 surplus.

Yet this institution would be able to start afresh in the future as if it did not have any reserves and would remain tax exempt while it built up its reserves to 3 percent against its outstanding loans.

A competitor institution which had no surplus accumulated prior to 1952 and which had accumulated reserves of 3 percent since 1951 would have to take into account that 3 percent reserve.

I want to ask you whether this is not unfair.

Mr. MILLS. I would like Mr. Sapienza to deal with the question if I may, but I might give you my own thought on it.

I think this is so, that an institution that had 12 percent in 1951 might not have built up its bad debt reserve to 3 percent.

My own observation would be that this would be a very limited number of institutions that would be fortunate enough to have such a large surplus reserve position.

But would you permit Mr. Sapienza to comment further?

Mr. SAPIENZA. I think the observations are correct that a bank which had surplus over 12 percent and did not make any accumulations would be entitled to start making accumulations under this law.

We think that actually in many cases even a bank with very large reserves of 12 percent might feel that they are not enough, and we think they ought to be allowed to go on the bad debt reserve method.

The CHAIRMAN. You think then this 1952 surplus which was accumulated tax free should not be taken into account to the extent necessary to fill up the institution's existing reserves to the 3-percent level?

Mr. SAPIENZA. Yes, sir. That was the situation under the 1951 act. We think it should be under the new law. We think that is correct.

Mr. MILLS. If I could add a practical comment on that, Mr. Chairman, the banks, by and large, the banks that happen to have over 12 percent surplus are those that have not enjoyed growth, and they are, generally speaking, in the more—I hate to use the word, but the more—backward areas, and these banks I do not think are an important factor in generating, that could be an important factor in generating tax income.

The CHAIRMAN. Isn't it true that even in 1952 when Congress granted the existing 12 percent reserve Congress required that surplus accumulated prior to 1952 would be taken into account?

Mr. SAPIENZA. Yes, sir.

Mr. MILLS. Yes, sir.

The CHAIRMAN. Thank you very much, Mr. Mills.

Mr. MILLS. Thank you, sir.

The CHAIRMAN. The next witness is Mr. Mark W. Saurs, Virginia Savings & Loan League.

Mr. Saurs, as a fellow Virginian, I welcome you here, sir.

STATEMENT OF MARK W. SAURS, EXECUTIVE VICE PRESIDENT, VIRGINIA SAVINGS & LOAN LEAGUE

Mr. SAURS. Thank you, Senator. It is indeed a pleasure for the Virginia Savings & Loan League to be present before this committee to offer any assistance it has to you.

The CHAIRMAN. We are glad to have you.

Mr. SAURS. A review of nonfarm mortgage recordings by type of lenders for mortgages of $20,000 or less from 1940 through 1961, will show the impact and service rendered to the home-buying public by our institutions. Consistently, savings and loans have been on top. Last year, 45 percent of these home loans were made by savings and loans. Another feature we have that differs from commercial banks is that we are in the mortgage market every day. Banks and other type lenders shift investments to suit their portfolios. According to the U.S. Bureau of Census, 62 percent of the American families owned or were buying their own homes as of December 1960. In Virginia this figure was 61.3 percent. Both percentages were increasing. These percentages, we think, indicate our services should not be unduly restricted through severe taxation.

The last census showed Virginia's population growth to be 19½ percent since 1950, or 1 percent above the national average. The population of our five larger metropolitan areas grew at a 40-percent rate. Although exact statistics have not been compiled, our members estimate that their mortgage activity is greater in each of these areas than any other group of lenders.

On April 2, 1962, Governor Harrison of Virginia told the State department heads that the population explosion will make it impossible to hold down State expenses. For the added income needed,

he is putting emphasis on industrial development and economic growth. The balance of agriculture, industry, and tourism will be stressed. In the October 1961 Monthly Review of the Federal Reserve Bank in Richmond, an economic profile on Virginia was ended in the following way—

> while unique in respect such as the amount of government activity and the characteristic enterprises * * * [the profile] reveals a State that is in step with the economic progress of the Nation.

In Virginia there are 29 Federal and 39 State chartered savings and loan associations. Combined assets on December 31, 1961, were $804 million. (For more detailed statistics, please refer to exhibit I, in the rear of this report.) Reserves and surplus were 7.2 percent of savings, 7.6 percent of loans, and 6.5 percent of assets. The FSLIC requires reserves of 5 percent of savings on the insured associations' 20th anniversary and thereafter associations must put a minimum 10 percent of net earnings to reserves until they reach 12 percent. Although the 7.2 percent is just slightly under the national average of 7.8 percent when compared with the 1950 figure of 10 percent for Virginia, we see a gradual erosion and particularly since 1959. The fight has been between attracting sufficient savings to meet mortgage demands, and the building up of reserves. The impact of any tax on savings and loans will be to further weaken reserves, because what will go to taxes would have been put into reserves.

Every dollar in our savings accounts earns dividends while banks do not pay for their demand deposits. Most banks assess service charges or sell checks on these accounts. As of December 31, 1961, Virginia banks, that are members of the Federal Reserve System, had $2.89 billion in total deposits, $1.76 billion in demand, and $1.13 billion in time. (See exhibit II.) The 1960 figures for all Virginia banks are:

	Billion
Total deposits	$3.26
Time deposits	1.28
Demand deposits	1.97

1961 figures on all Virginia banks were not available, but the growth in total deposits since 1957 has averaged $87 million per year. (See exhibit III.)

Savings and loan lending in Virginia has increased from $86 million per year in 1957 to $173 million for 1961, and total mortgages held went from $386 million in 1957 to $684 million last year. We, to the best of our ability, try to meet mortgage demands that exist in Virginia. This record is particularly revealing when compared with commercial bank lending for the 1957–61 period. Banks averaged mortgage growth of $17 million per year while associations averaged $133 million per year. This is the effect of 55 Virginia savings and loan associations compared with that of 301 State and National banks.

Late last summer and again this winter, commercial bankers have said they will take up the slack occurring in the home mortgage market that would result from a tax on savings and loans. In the Richmond, Norfolk, Roanoke, Lynchburg areas real estate loans as of March 31, 1962, declined 3 percent from January 1, 1962, in five banks in these cities. Our associations lending for January, February 1962, was 19 percent ahead of the comparable months in 1961

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and mortgages were up 3.6 percent over January 1, 1962. Early March reports show net gains.

Eighty-five percent of Virginia savings and loan assets are in mortgages. The maturities of these loans run from 20 to 30 years. The average maturity of loans is approaching 25 years. On most all new homes, the average loans are 75 to 80 percent of appraised value, with 25-year terms. We find some members now making 85 to 90 percent conventional loans. With costs at their present level, and the accumulation of downpayments difficult, we recognize the public needs by providing this type financing. In 1961, we estimate that 11,000 home purchases were financed by our members.

The House bill would have taken an estimated $1 million out of Virginia last year. To the overall Federal revenue this is insignificant, but it would result in a weakening of our reserve growth and would eventually lead to a reduction in mortgage lending.

We believe that our lending accelerates the velocity of funds so great that any tax is insignificant compared with the revenue received from all fields related to homebuilding and financing. Reflect for a moment on the activity spurred by homebuilding: wages for labor, sale of land, subdividing and surveying, new roads, grading, sewerage connections, concrete, steel, brick, lumber, roofing, flooring, electrical wiring, plaster, paint, paper, glass, appliances, furniture, carpeting, landscaping, and others, to say nothing of the profits that have been earned in each of these fields. The full impact of these on the economy is tremendous, and every dollar aids the commercial banking system.

Commercial bankers would have you believe that taxwise we should be treated identically as they. While it is true that both of us are financial institutions, we are highly specialized. We pay all of our account holders, our investment field is restricted, and our risk is long term. On the other hand, commercial banks have wide investment authority, and pay only approximately one-third of their account holders, and have relatively short-term risks. It seems academic that if a lender has all of its eggs in one basket that it needs greater reserves for losses than a lender who has diversified risks.

Savings and loans do not want to become commercial banks. We do not think Congress will tax us into impotency. The initial loser would be the homebuying American public.

The provisions of H.R. 10650 apply to savings and loans in two major ways. One is the adjustment of our income-tax formula as set out in section 8; and the second is the withholding. The change of regulation permitting commercial banks to pay higher rates on time deposits, is also adding to our difficulties.

The full impact of the tax changes, plus the increased savings competition, will be quite staggering. If it is inevitable that these measures will become law, then it would seem to be in the best interests of the economy not to impose the whole tax on us the first year, but to phase section 8 in over a several year period. Thank you, gentlemen.

(The exhibits attached to Mr. Saurs' statement follow:)

EXHIBIT I

[Dollars in thousands]

Year	Number of associations	Assets	Savings	Total net loans	Annual loans	Reserves and surplus	Percent reserves to assets	Percent reserves to loans	Percent reserves to savings
1950	VA 41	$156,023	$130,437	$135,546		$13,100	8.4	9.7	10.0
1956	VA 48	414,572	364,214	352,879	$83,017	28,934	7.0	8.2	7.9
1957	VA 49	458,652	410,239	386,565	86,770	32,559	7.1	8.4	7.9
1958	VA 50	522,880	465,825	437,997	114,888	36,417	7.0	8.3	7.8
1959	VA 50	588,095	519,001	504,660	138,238	41,227	7.0	8.2	7.9
1960	VA 54	685,408	609,723	587,525	153,043	47,024	6.9	8.0	7.7
1961	VA 55	804,752	719,331	684,440	173,648	52,064	6.5	7.6	7.2
1950	District 447	1,961,171	1,651,935	1,676,130		141,910	7.2	8.4	8.6
1956	District 561	5,892,678	5,168,685	4,968,549	1,475,779	319,918	6.7	7.9	7.6
1957	District 576	6,627,154	5,863,230	5,561,240	1,427,295	454,693	6.9	8.2	7.8
1958	District 597	7,641,089	6,730,788	6,349,572	1,756,520	525,917	6.9	8.3	7.8
1959	District 619	8,790,547	7,796,501	7,466,358	2,199,432	603,848	6.9	8.1	7.7
1960	District 641	10,012,011	8,827,907	8,475,957	2,108,435	694,291	6.9	8.2	7.9
1961	District 660	11,448,981	10,099,565	9,644,316	2,492,208	792,350	6.9	8.2	7.8

Source: Federal Home Loan Bank, Greensboro.

EXHIBIT II.—*All Virginia member banks as of Dec. 31*

[Amounts in thousands of dollars]

	1957	1958	1959	1960	1961
Real estate loans	323,975	362,351	404,498	414,822	434,868
Secured by farmland	28,967	31,065	35,202	35,298	37,616
Secured by residential property	227,910	252,714	279,767	283,012	296,816
Insured by FHA	42,566	50,416	55,551	53,812	52,820
Insured or guaranteed by VA	35,210	31,476	28,689	25,802	22,654
Not insured or guaranteed by FHA-VA	150,143	170,822	195,527	203,398	221,342
Secured by other properties	67,089	78,572	89,529	96,512	100,436
Total deposits	2,398,375	2,557,442	2,615,574	2,669,798	2,896,321
Demand deposits	1,552,573	1,598,466	1,629,026	1,658,758	1,761,671
Time deposits	845,802	958,976	986,548	1,011,040	1,134,650
Gross loans	1,124,624	1,201,485	1,345,996	1,431,527	1,522,481
Reserves and other cash	586,009	579,177	597,134	576,239	619,800
Reserves and other cash as fraction of deposits	24.4	22.6	22.8	21.6	21.4
Reserves and other cash as fraction of real estate loans	180.9	159.8	147.6	138.9	142.5
Reserves and other cash as fraction of gross loans	52.1	48.2	44.4	40.3	40.7

Real estate loans, percentage changes from first week in January through last week in March, Virginia weekly reporting banks:[1]

Year	Percent
1957	+0.1
1958	+1.7
1959	+7.0
1960	-.8
1961	-.6
1962	-3.0

[1] Banks in Richmond, Roanoke, Norfolk, and Lynchburg report loans weekly. (1957, 12 banks; 1958, 11 banks; 1959, 11 banks; 1960, 5 banks; 1961, 5 banks; 1962, 5 banks.)

Source: Member bank call reports.

EXHIBIT III.—*All Virginia banks, as of Dec. 31*

[Amounts in thousands of dollars]

	1957	1958	1959	1960	1961
Real estate loans	415,157	462,089	515,474	532,395	(1)
Secured by farmland	40,584	43,009	48,764	49,805	(1)
Secured by residential property:					
Insured by FHA	47,953	57,455	63,420	61,586	(1)
Insured or guaranteed by VA	39,820	36,161	33,314	29,732	(1)
Not insured or guaranteed by FHA or VA	202,660	227,932	257,712	269,242	(1)
Secured by other properties	84,140	97,532	112,264	122,030	(1)
Total deposits	2,913,473	3,116,232	3,196,486	3,264,111	(1)
Demand deposits	1,847,687	1,912,071	1,954,301	1,979,321	(1)
Time deposits	1,065,786	1,204,161	1,242,185	1,284,790	(1)
Gross loans	1,356,960	1,452,030	1,623,049	1,728,210	(1)
Reserves and other cash	682,800	675,543	694,013	671,514	(1)
Reserves and other cash as fraction of deposits	23.4	21.7	21.7	20.6	(1)
Reserves and other cash as fraction of real estate loans	164.5	146.2	134.6	126.1	(1)
Reserves and other cash as fraction of gross loans	50.3	46.5	42.8	38.9	(1)

[1] Not available.

Sources: 1957-60 annual reports of the Federal Deposit Insurance Corporation.

EXHIBIT IV.—*Valuation of building permits issued in 38 cities*

	February 1962	February 1961	2 months 1962	2 months 1961
District of Columbia, Washington	$16,763.2	$6,776.5	$26,094.3	$22,723.0
Maryland, total, 6 cities	5,469.5	3,816.1	20,847.0	8,492.0
North Carolina, total, 11 cities	12,723.9	9,362.2	23,964.4	20,542.7
South Carolina, total, 4 cities	3,136.6	1,556.1	5,158.8	2,789.6
Virginia:				
Danville	691.3	225.0	1,175.7	366.2
Hampton	1,434.7	933.1	3,877.8	2,423.0
Hopewell	112.6	131.6	512.2	211.0
Lynchburg	406.3	628.8	1,346.4	931.8
Martinsville	163.4	314.1	326.1	452.0
Newport News	764.7	766.5	1,584.5	7,605.8
Norfolk	1,150.0	2,269.4	4,190.8	3,757.3
Petersburg	44.0	68.0	183.5	114.5
Portsmouth	553.3	268.8	1,187.6	2,007.6
Richmond	764.0	834.3	4,288.3	1,277.7
Roanoke	593.8	1,250.3	1,204.8	1,780.1
Staunton	396.4	474.1	504.4	559.1
Winchester	88.3	36.0	182.6	64.7
Total, 13 cities	7,162.8	8,200.0	20,564.7	21,500.8
West Virginia, total, 3 cities	933.2	480.9	2,342.8	1,252.0
District total	46,189.2	30,191.8	98,972.0	77,300.1

Source: Compiled by Research Department, Federal Reserve Bank of Richmond, Mar. 13, 1962.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. No questions.

The CHAIRMAN. Mr. Saurs, thank you very much, sir, for your statement. I hope you come before the committee here again soon.

The next witness is Mr. James O. Fogleman of the League of Louisiana Savings & Loan Associations. Please proceed, Mr. Fogleman.

STATEMENT OF JAMES O. FOGLEMAN, VICE PRESIDENT AND SECRETARY, LEAGUE OF LOUISIANA SAVINGS & LOAN ASSOCIATION, LAKE CHARLES, LA.

Mr. FOGLEMAN. My name is James O. Fogleman, vice president and secretary of the Calcasieu Savings & Loan Association of Lake Charles, La.

I am here representing the League of Louisiana Savings & Loan Associations as its president.

In Louisiana, the savings and loan industry is represented by 88 associations; 66 of them are State chartered, 22 are federally chartered. All of the active associations, with the exception of one very small, country association, have their savings insured by the FSLIC. All are members of the FHLB of Little Rock. All are mutual associations. The total assets of the association now exceed $1 billion, and that, in Louisiana, represents one of the major industries in the State. Of the 88 associations in the State, 32 are located in the city of New Orleans, and these associations hold almost half of the assets in the State. The other 56 associations, which hold more than a half billion dollars in assets, are country associations. They are located in almost every town or community in the State. Throughout the State, the major portion of all home loans is made by our industry. In most rural areas, the only type of home loan available on long enough terms and at fair interest rates is from the home-owned and home-operated savings and loan association. The only alternative is borrowing from the individual money lenders at unduly high interest rates and on terms too short to allow the average man to repay.

WITHHOLDING TAX

Oftentimes, it seems as if, at times like this, the fact is overlooked that our institutions were organized and chartered not only for the purpose of providing home loans to promote homeownership, but also for the purpose of encouraging thrift.

Comprising the approximately $950 million in savings accounts in Louisiana are almost 400,000 accounts. This represents 1 account for every 8 people of the 3,257,022 population of the State. Our industry has done a tremendous job in promoting this concept of thrift. No thinking person can depreciate the importance of capital accumulation through savings on the economy of our Nation. No continued increase in this habit of saving is possible without extensive promotion, and this costs money. The cost of administering the proposed withholding tax measure would eat heavily into funds available for the promotion of thrift. It has been reliably estimated that the cost to Louisiana associations alone would approximate $800,000 per year.

Four hundred thousand individuals, or one out of every three families in Louisiana alone, it is estimated, will endure unnecessary hardship imposed upon them by complicated procedures to obtain proper credit or refund of amounts withheld.

RESERVES

In the April 2 issue of the Wall Street Journal appeared an article expressing grave concern over the increasing number of foreclosures and bankruptcies throughout the country. Now, more than in the past 30 years, is an urgent need for large reserves to guard the safety of the savings of these multiplied thousands of investors in our associations. Recent experiences have again demonstrated how quickly can evolve a situation where losses of 10, 15, or even 20 percent on the foreclosures can occur. These losses can and are occurring in spite of a relatively healthy national economy. How much more important they could be in times of national economic hardship. Both the withholding tax proposal and the income tax proposals could dangerously impair and diminish the necessary building of these reserves. Most everyone believes in the old adage of "saving for a rainy day." We in the savings and loan industry believe in practicing what we preach.

MORTGAGE RATES

Most economists agree that there is a large housing market which is at present untapped because of the increasing costs of home construction. This fact is attested to by the constantly increasing pressure for Federal subsidization in low- and middle-income brackets. The current withholding tax proposals and income tax proposals will unquestionably intensify the trend toward higher rates in mortgage money. For every increase in the cost of mortgages, there is a corresponding decrease in the number of borrowers who can afford to pay. Consequently, there is an increase in the number of people needing Federal aid in providing adequate housing for their families.

The diminished rate of housing starts also reflects itself in an increase in unemployment. Today, according to the Louisiana Employment Security Division, there are more than 70,000 in the ranks of the unemployed, almost 20,000 of them in the construction and related industries. This legislation would tend to increase the ranks of the unemployed in Louisiana.

OUR FAIR SHARE

In conclusion, may we point out that all of the earnings of a mutual savings and loan association are distributed in the form of dividends to the savers with the exception of those amounts transferred to reserve accounts against losses. The savers in our associations pay taxes on these distributed dividends at ordinary income tax rates with no exclusions. At the minimum rate, the amount of tax paid in 1961 would amount to more than $7½ million in income taxes paid by the 400,000 savers in the 88 Louisiana associations. There can be no doubt that few industries generate that much direct income to the Federal Government, while at the same time living up to the high purpose of promoting thrift and home ownership.

The CHAIRMAN. Any questions? Thank you very much, Mr. Fogleman.

The next witness is Mr. Carl F. Distelhorst, executive vice president of the Florida Savings & Loan League, Orlando, Fla.

We are pleased to have you, Mr. Distelhorst.

STATEMENT OF CARL F. DISTELHORST, EXECUTIVE VICE PRESIDENT, FLORIDA SAVINGS & LOAN LEAGUE, ORLANDO, FLA.

Mr. DISTELHORST. Mr. Chairman, my name is Carl F. Distelhorst and I appear here as executive vice president of the Florida Savings & Loan League whose 113 members represent over 99 percent of the savings and loan business in our State.

ROLE OF SAVINGS AND LOAN ASSOCIATIONS IN FINANCING HOMES IN FLORIDA

Florida has 117 savings and loan associations with total resources in excess of $3,850 million. For the year 1961 these associations extended a total of $775,560,000 in mortgage credit primarily for 69,400 homeowners to buy or build their homes or for other purposes. Their total mortgage loans now outstanding exceed $3,150 million. They have 1,400,000 savings account holders, over 90 percent of whom are residents of Florida and over 350,000 borrowing customers. In 1961 savings in Florida savings and loan associations increased by $420,733,000, or by 14.5 percent. This compares with a 14 percent savings increase for all the savings and loan associations in the Nation.

As the following table on nonfarm mortgage recordings shows, savings and loan associations are the major single source of home financing in Florida, accounting for 41.3 percent of total home mortgage recordings of $20,000 and under in 1961. With Florida savings and loan lending volume up 30 percent for the first quarter of 1962 over a year ago it is evident that our proportion of total home financing volume will be somewhat higher this year. The only other major source of home financing is from out-of-State financial institutions. In the mortgage recordings table which follows the out-of-State lending is represented in the miscellaneous category, most of which are mortgage bankers who sell their mortgages to out-of-State investors. Commercial banks and insurance companies combined provide only about 10 percent of Florida's home financing. Banks are inclined to confine their home loans to 3- to 5-year maturities.

Estimated amount of nonfarm mortgages of $20,000 or less recorded in Florida

Type of lender	1961		1960		1959	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
Savings and loan associations	$634,246,000	41.5	$609,228,000	37.7	$669,198,000	38.1
Insurance companies	40,636,000	2.7	47,771,000	3.0	59,839,000	3.4
Commercial banks	118,278,000	7.7	108,574,000	6.7	122,153,000	6.9
Individuals	275,903,000	18.1	327,822,000	20.3	353,740,000	20.1
Miscellaneous	458,491,000	30.0	523,359,000	32.3	554,966,000	31.5
Total	1,527,554,000	100.0	1,616,754,000	100.0	1,759,896,000	100.0

Source: Operating Analysis Division, Federal Home Loan Bank Board.

Over half of the institutionally held home mortgage loans in Florida are held by savings and loan associations. These mutual thrift and home financing institutions are clearly a major segment of Florida's economy and particularly home construction and home financing so

whatever is done to encourage or to hinder their operations will have a significant impact on the economy of the State. In this connection, with the acceleration of Atlantic Missile Range activities in the Cape Canaveral area plus all of the collateral economic activity this generates, the home financing industry in Florida must be prepared to meet the housing requirements of a new population explosion from this source in addition to the acceleration of family formation beginning in the mid-1960's.

OUR POSITION ON PROPOSED TAXATION OF MUTUAL SAVINGS INSTITUTIONS

The Florida Savings & Loan League supports the testimony presented today by the United States Savings & Loan League and the National League of Insured Savings Associations. We understand the need of the U.S. Treasury for additional tax revenue. However, it would be unfortunate for our savings and borrowing customers and for the economy of Florida and the Nation if the type of tax imposed would weaken the financial structure of these institutions and substantially reduce the volume of home mortgage credit which they could make available for home construction and home ownership. In other words, an appropriate tax formula must:

1. Permit the savings and loan associations to continue to pay competitive dividends to their savers, taking into consideration the increased rates being paid on commercial bank time and savings deposits.

2. Permit savings and loan associations to not only accumulate adequate bad debt reserves but to also build an adequate capital cushion comparable to that of commercial banks and related to the type of business they conduct.

With respect to dividend rates, a tax which would necessitate Florida associations to reduce their dividend rate by one-fourth of 1 percent below the current prevailing rate of 4¼ percent per annum would reduce the available annual supply of home financing in Florida by $200 million to $250 million. This means we would finance some 20,000 to 25,000 fewer homes per year with not even a reasonable indication that Florida's commercial banks would take up the slack. Since out-of-State mutual savings banks and savings and loan associations are heavy purchasers of mortgages in Florida a tax which would reduce their savings flow would further reduce the supply of out-of-State funds to meet Florida's home financing requirements.

With respect to the necessity for a tax which will permit the accumulation of an adequate capital cushion we wish to point out that bad debt reserves are neither surplus nor capital and should not be confused with a financial institution's need for capital. The primary purpose of the capital cushion is to protect savers (as well as the Government agencies insuring such accounts) from abnormal or unusual losses that are unpredictable both in time and amount and that may arise out of economic recessions, defalcations, mismanagement or for other reasons which no one can foresee. Since mutual institutions cannot increase their capital cushion through the sale of securities to the public, as can commercial banks, it is imperative that whatever tax is imposed on the mutuals be one that permits them to accumulate a formidable capital cushion.

In order to measure the effect of the several proposals to change our tax status we asked our member associations to supply the necessary data, based on operations for the calendar year 1961. Voluntary responses were received from exactly 100 associations which represented 86 percent of the total number and 93 precent of the total assets of all savings and loan associations in Florida.

IMPACT OF TAX PROPOSAL MADE BY TREASURY SECRETARY DOUGLAS DILLON TO SENATE FINANCE COMMITTEE, APRIL 2, 1962

On April 2 Secretary of the Treasury Douglas Dillon suggested a tax formula for mutual thrift institutions which would allow them—

> to deduct from net income after distributions to depositors an amount equal to 3 percent of net additions to real estate loans, as in the House bill, or 33⅓ percent of retained income before deduction of a reserve for bad debts. * * * Under these alternatives mutual thrift institutions would pay tax on about 80 percent of their net operating income, and thus this approach would achieve substantial equality in the taxation of competing financial institutions.

The term "net operating income" was defined by Mr. Dillon as net—

> after deduction of a reasonable reserve for bad debts and after distributions to depositors.

From his testimony it is presumed that Mr. Dillon regards a "reasonable reserve for bad debts" to be 3 percent of the net increase in real estate loans.

If the tax formula recommended by Mr. Dillon to the Senate Finance Committee had been in effect in 1961 here is how it would have affected the 100 reporting Florida associations:

1. Nine associations would have had insufficient income, after taxes, to make the minimum required transfers to the Federal savings and loan insurance or other loss reserves. These associations would have been forced to reduce dividends paid on savings to under 4 percent per annum.

2. Thirty-seven associations would have added to their loss reserves and surplus amounts of less than 5 percent of their net savings increase. The signficance of this is: (1) There is a statutory requirement that every insured association must, by the 20th anniversary of insurance of accounts, have a Federal insurance reserve at least equal to 5 percent of total savings and thereafter maintain such reserve at 5 percent or more, and (2) unless associations can add to their loss reserves and surplus substantially more than 5 percent of their growth each year they will never be able to build a capital cushion which is essential to retaining public confidence. The actual addition to loss reserves and surplus for the Florida associations both in 1960 and 1961 was 8.3 percent of their net savings increase. Prudence would require these 37 associations and many others to either reduce the dividends or to substantially slow down their rate of growth and the number of homes they finance each year.

3. Fifty-two of the 100 reporting associations would have paid taxes on 100 percent of their "net operating income" and 80 would have paid taxes on over 80 percent of their net operating income. For the 100 Florida associations combined, in 1961 they would have paid taxes on 93.4 percent of their "net operating income." This is somewhat more than the 80 percent of net on which commercial banks pay taxes.

Accordingly, Mr. Dillon's tax proposal would by his own comparison be a penalty tax on Florida's savings and loan associations.

Since the close of 1961 the prevailing dividend paid on savings in Florida savings and loan associations has risen from 4 to 4¼ percent, reflecting the effect of the higher interest rates banks can now pay on savings and time deposits. Accordingly, we analyzed the effect which Mr. Dillon's proposal would have had on 1961 savings and loan operations had the 4¼ percent dividend rate then been in effect. The higher dividend rate will, of course, result in lower taxes being paid but this will also be true of commercial banks which raised their interest rates on savings. On the other hand, the combined impact of a higher dividend rate plus taxes in 1961 would have resulted in the following consequences:

1. For the 100 reporting associations combined their additions to loss reserves and surplus, after taxes, would have been only 4.80 percent of their savings increase. This is less than the minimum statutory requirement of building and maintaining a Federal insurance reserve of a minimum of 5 percent of total savings. By actual count 59 associations would have added to reserves and surplus less than 5 percent of their net savings increase. Another 20 percent of the associations were on the borderline in this respect. All of these associations and many others whose additions to reserves were only slightly above the minimum would either had to slow down their growth or reduce dividends.

2. At least 19 and possibly as many as 26 associations would have been forced to reduce their dividends by reason of their inability to meet annual supervisory reserve requirements after the payment of taxes.

3. Of the 100 associations 60 would pay taxes on 100 percent of their net operating income and 84 associations would pay taxes on over 80 percent of their net operating income. This is substantially higher than the 80 percent of net operating income on which commercial banks pay taxes.

In summary, the alternate tax proposal suggested by Secretary Douglas Dillon would:

1. Cause savings and loan associations to pay taxes on a somewhat higher percentage of their net operating income than is paid by the commercial banks.

2. Would not permit many associations to meet minimum annual transfers to reserves as required by law or regulation, after payment of taxes, thus forcing them to reduce the return they pay on savings. In turn this would substantially reduce their funds available for home financing.

3. A substantial percentage of the associations would be unable to accumulate or maintain a reasonable capital cushion, in addition to bad debt reserves, and in prudence would either need to reduce their dividend rates or adopt a plan of slow growth. Either would reduce the volume of available home financing funds.

The enactment of Mr. Dillon's alternate proposal would reduce the number of houses financed in Florida by at least 25,000 per year.

IMPACT OF H.R. 10650, SECTION 8 ON FLORIDA ASSOCIATIONS

Now let us see what the impact would have been on Florida's savings and loan associations had H.R. 10650 as now drafted been effective for calendar 1961.

On the favorable side of this proposal it can be said that all but four or five of these associations could have paid their taxes and met the minimum supervisory requirements of additions to their Federal insurance and other reserves without having to reduce dividends below the 4-percent rate which then prevailed. In the aggregate, these 100 associations would have been able to add to bad debt reserves and surplus, after taxes, at the rate of 6.85 percent of net savings increase. While this is above minimum statutory requirements, additions to bad debt reserves and capital at the rate of 6.85 percent of growth is still below commercial bank supervisory standards.

But in the light of the recent increased rates paid on bank savings which forced Florida's savings and loan associations up to a 4¼-percent dividend rate it is now necessary to take another look at what the provisions of H.R. 10650 would mean to the savings and loan business. For this purpose we adjusted the actual operating results of the 100 reporting associations to reflect a 4¼-percent dividend rate in place of the 4 percent actually paid.

Here is what we found:

1. At a 4¼-percent dividend rate additions to reserves and surplus would have been at the rate of 5.47 percent of net savings growth (compared with 6.85 percent under the 4-percent dividend). Exactly half of the associations would have increased reserves and surplus at the rate of less than 5 percent of their net savings increase—the minimum necessary to meet the long-range statutory requirements of the Federal Savings and Loan Insurance Corporation.

2. At least 10 associations and more probably 20 associations would have found it imperative to reduce their dividend rate in order to meet the minimum annual requirement of additions to loss reserves.

Accordingly, under the changed circumstances of a prevailing 4¼-percent dividend rate for Florida associations, the tax load which would be imposed by H.R. 10650 would be harmful to maintaining the high level of home financing which Florida's resurging economy requires. A dividend reduction at this time would materially slow down the flow of savings into savings and loan associations.

As an alternative we respectfully ask you to seriously consider a phase-in period wherein the level of taxation as now appearing in H.R. 10650 would be reached after a period of several years. This should provide a period in which to adjust to what otherwise would be a severe impact to absorb in 1 year.

The CHAIRMAN. Thank you very much, Mr. Distelhorst.

The next witness is Mr. Robert L. Palmer of the Savings & Loan League of Minnesota.

STATEMENT OF ROBERT PALMER, PRESIDENT, PIPESTONE FEDERAL SAVINGS & LOAN ASSOCIATION, PIPESTONE, MINN., ON BEHALF OF SAVINGS & LOAN LEAGUE OF MINNESOTA

Mr. PALMER. Mr. Chairman, I think I should identify myself first as a peculiar hybrid character. I am a commercial banker operating a small country bank for the last 25 years.

My name is Robert Palmer and I am president and managing officer of the Pipestone Federal Savings & Loan Association, Pipestone, Minn.

This association has assets of approximately $20 million and is located in a county seat town having a population of approximately 6,000.

Minnesota is served by over 20 associations located in the metropolitan centers of Minneapolis, St. Paul, and Duluth, but approximately 60 associations are scattered throughout the State in the small towns and cities with assets ranging from $1 million to $25 million.

I won't attempt to cover the broader issues of the proposed legislation as originally presented by the U.S. Savings & Loan League, but rather will confine my remarks to the case of the small town, the small communities, and the importance of local savings and loan associations to their economy.

Since 1945 our association has been serving 42 towns and cities located in southwest Minnesota, southeast South Dakota, and northwest Iowa. These towns range from a few hundred in population to the city of Sioux Falls which has a population of 60,000. During most of the 15 years we have been actively servicing the entire area, we have been the principal source of mortgage credit in about two-thirds of the towns and cities. In approximately one-half of the towns we have been nearly the sole source of mortgage credit.

There are approximately 300,000 people living in a 50-mile radius of Pipestone, the legal lending area served by our association, in which we are actively making loans.

In my judgment, more than one-third, or 100,000, are in towns and cities in which we can be reasonably sure there is no economic deterioration evident.

There are at least 100,000 people living in more than 30 of these towns in which we have to admit there are problems caused by farm population shrinkage, loss of farm income, and other factors adversely affecting their future growth.

The typical towns, both county seat and smaller towns, are trade centers for the agricultural population and as the farm population has been declining, this has had an adverse effect on the economy of all these towns and cities. Practically all of the towns have lost their theaters, some of their restaurants, most of their automobile dealers, and half or more of their farm implement dealers.

A survey made 2 years ago by our office on the population trends in two rural townships in our community showed a reduction of 54 adult voters in 2 townships in a 10-year period.

We have every reason to believe that the farm population will continue to shrink, which will automatically affect all the small rural towns serving the agricultural areas.

Some of these communities may improve their position, or at least hold their own populationwise if they can induce new business and small industry to locate within their boundaries.

Two basic things that every community will have to offer people as an inducement to come in are (1) satisfactory housing with reasonable long-term financing, and (2) good school systems.

The small towns of rural America are important sources of leadership in all walks of life. Keith Funston, president of the New York Stock Exchange, was born and received part of his education at Romona, S. Dak., a very small town of under 500.

Within the last few weeks both Houses of Congress honored Col. John Glenn, who has almost become a symbol of the ideal American. Colonel Glenn is from a small Ohio town much like the communities we are talking about.

Both of our present Senators from Minnesota were from quite small towns. Senator McCarthy, a member of this committee, is from Watkins, Min., a town of under 1,000. And his colleague in the Senate, Senator Humphrey, was born in a very small town in South Dakota, and educated at Doland, a town of under 500.

It will take the best efforts of all of the local citizens, business and professional leaders, and financial institutions to keep these towns from becoming second-class communities with second-class schools.

We believe the savings and loan associations are among the institutions with the greatest potential to prevent the deterioration of these towns.

I am here today to respectfully request this committee not to adopt tax provisions which will cripple these associations in their efforts to stem the tide.

Thousands of saving and loan institutions are ready and willing to take the risks incident to lending in these towns in an effort to preserve the values and the futures of these communities. But to do so, mutual institutions must have adequate reserves to protect their savers from loss.

In the questioning this morning I think there was some interest shown as to how much of this business as a whole consisted of the type of associations I am talking about serving the smaller communities. There are something over 2,000 associations of under $25 million serving in cities, or located in cities under 25,000 population.

Now, here are two examples of high risk loans made in small towns where the Veterans' Administration lost on each from 25 to 50 percent. Both of these loans were originally handled by our institution. One involved a loan made in a small South Dakota town of under 100 population where the cost of the property to the owner was $14,000.

This property was appraised by the VA in 1954 for $12,700, and the VA guaranteed a loan in the amount of $10,000 on August 16, 1954.

I think they must have taken into consideration the location of the property in revising the value of it down to that point. Also, this amount is substantially under our downpayment involved, and would be typical of VA lending.

The loan subsequently defaulted and was deeded to the VA in November of 1958 and we then received under our claim $10,252. This was ultimately sold on contract for deed by the Veterans' Administration for $7,500. The new contract called for 5-percent interest on

terms of 25 years and we have been informed last week that this contract is also in default.

The second VA case occurred in a small Minnesota town. This was an older property consisting of a business rental and two apartments. The original VA appraisal in 1952 valued the property at $11,000. The loan was closed in May of 1952 in the amount of $10,000 and was acquired by deed to the VA in March of 1953.

The VA paid a claim of $10,455 and subsequently sold this property on contract for deed in 1955 for $5,000 with only $500 down and a balance of 5 percent—on this piece of property that had three rentals on it—with monthly payments of only $35.59 per month. The VA loss on this property was well in excess of 50 percent.

I cite these examples of mortgage loss to indicate that certain towns within our lending area are in distress and certainly aren't prospering with the general tempo of the economy. They are not typical, but they do illustrate that even in what is generally regarded as a healthy economic climate, soft spots do exist.

Carrying this line of reasoning further, it must be remembered that several cases of mortgage loss or distress in a rural community are more strongly felt and have greater ramifications on the economy in general than do loses that are absorbed in a metropolitan area.

I would say this. Where in the metropolitan area a number of different associations are participating in the lending, the losses that occur there will be divided among a great many different institutions. In the case I am talking about, the loss will be concentrated primarily in the one institution serving the particular area.

Over the past decade or so, most of these small communities, through school consolidations, have become the center of education for their own population and all of the surrounding rural population.

One of the problems faced by the school administration in these communities has been to furnish modern housing on satisfactory mortgage terms. Several school administrators have told us that satisfactory housing and fair financing terms have been more important in enabling them to get capable teachers than the salaries that could be offered.

We have been making loans from 80 to 90 percent and up to 25 years for some of these people in all of the towns we serve. Such loans are necessary to meet the housing needs of the people in the school system and the business and professional people who make their homes in these small towns. In our business we have been taking the higher risks involved in this kind of lending.

Substantial reserves have made the taking of such risks possible and we will probably have to increase our risktaking in the future, if we intend to continue serving this area.

In many small communities the local savings and loan association is the only, and certainly the dominant, home-mortgage lender in the community. Because of their dominant position they are forced to go into loans of above average risk for the general welfare of the community in keeping it thriving and growing. If these small towns are to prosper and if new business and industry are to be attracted, then there will necessarily be a projection of past experience in acceptance of high risk loans into the future.

These, I stress, are not loans that ultimately would be sought by a savings and loan association in the normal course of its operation, but

are made necessary because of the community's need to attract and hold business and industry within the locality.

To do this, facilities must be made available to business to induce their continued operation at the local level. The facilities that I am speaking of are homes, schools, and commercial facilities that combine to make a community not only a desirable place to live, but a profitable place in which to do business.

This leads us right back to the role of the savings and loan association. Efforts have been made in recent years to retain what business and industry a small town had by accepting mortgages that would fall in the category of "above average" in risk. Associations did this for a number of reasons.

First, being the dominant home lender in the community the townspeople naturally looked to it for assistance in helping the community remain a thriving locality.

Secondly, if these loans weren't made simply because the risk in making the mortgage was out of line with accepted practice, the lending institution would be in the position of aggravating and worsening an already distressed situation.

On one hand, it was a case of community responsibility; on the other hand, it was a case of business judgment brought about by a local economic problem.

We feel these communities can be saved, are worth saving, and can be returned to a sound economic condition, if the proper incentive is given to local savings and loan associations in their efforts to revitalize the locality.

They may not be as large or as prosperous as past days, but they would be able to grow and thrive with the economy of our country in general, rather than slide into community bankruptcy.

This brings us to the crux of the problem. Savings and loan associations in small towns want to do this job, have shown a willingness to do so in the light of past experience and will continue to channel their energies in this direction. But to do so, adequate reserves must be available to cover the higher incidence of above average risk loans.

It is highly probable that we will need all of our present reserves in most of our institutions to protect ourselves from any loss which may result from the kind of risk mortgages already made; and if we are to continue our efforts to serve these various sized communities, we will need a prudent and equitable reserve formula.

If for any reason private enterprise cannot continue to take these risks, then pressure will ultimately be brought to bear on the Federal Government to furnish credit under these circumstances.

Gentlemen, in my opinion, if adequate reserve provisions are not granted savings and loan associations in their efforts to revive and stimulate business and commerce in small communities, then the decision might possibly have to be made by the local associations to forgo acceptance of any further high-risk loans.

In the interest of keeping the association in a solvent position, this would effectively mean that there would be a drying up of local mortgage credit which would further induce an exodus from the community.

Not only conventional loans would be in jeopardy but FHA and GI loans as well.

Conceivably, the dollar loss in defaulted FHA and VA mortgages to the Government in slowly dying communities could be greater than the expected revenue from the proposed tax as presented by the House Ways and Means Committee.

Thank you very much for the privilege of appearing.

The CHAIRMAN. Mr. Palmer, a commercial bank is permitted to establish reserves in an amount equal to three times its annual loss experience during the worse 20 consecutive years since 1927. This formula which takes into account the depression experience of the 1930's has produced an average reserve ceiling of 2.4 percent of an uninsured loan. Are there any statistics indicating that the loss experience of the mutual savings institutions during the 1930's was significantly worse than the loss experience of the commercial banks?

Mr. PALMER. In the 1930's?

The CHAIRMAN. In the 1930's; yes.

Mr. PALMER. Senator, I believe that the statistics on the losses of the commercial banks in that particular period would be distorted by the fact that several thousand of the closed banks at that time had losses ranging up to nearly 100 percent. I think these losses that you referred to from the statistics, are from the banks that are now in existence—those who survived. I know as an attorney I acted as attorney for a number of receivers of banks in the late 1920's and early 1930's in southwestern Minnesota.

We had a number of banks that were closed at that time in which the depositors received as little as less than 1 percent and a number of them where their salvage was only 15 or 20 percent.

Now, in my own bank, a small town, we have actually had charge-offs, since 1933, of $140. This is pretty insignificant in the banking business. We do not even use a reserve method there.

The CHAIRMAN. 1933?

Mr. PALMER. I went into the banking business, Senator, in 1933.

The CHAIRMAN. And charged off $140?

Mr. PALMER. Right, in the bank.

The CHAIRMAN. You are just as good in the building and loan, are you not?

Mr. PALMER. Senator, my savings and loan losses have been greater than that, substantially. We have a substantially larger operation. I will say, though, that I am perfectly conscious now of the fact that my portfolio has immediate losses that I think I can anticipate within the next 2 years that will be, I would say, possibly 100 times the losses I have taken over the last 31 years.

The CHAIRMAN. What is the cause of that—because the small towns are not prospering?

Mr. PALMER. Not altogether, sir.

When I went into the savings and loan business, typically we made loans for 8 and 10 years. We made them maximum for 66⅔ percent. Equities were built up rapidly. The amount of the loans in most cases were only a few thousand dollars. The total loss you can have on a $2,500 loan is not very significant.

Now we are currently making loans in the $12,000 to $18,000 brackets, 25 years is common, and the equity accumulation of the homeowner is very slow; in fact, I characterize a good many of the people that are getting these very low downpayment loans as "land-

lordless tenants." They have all the characteristics of the tenant, except they do not have any landlord to point the finger at when they want something done. They actually do not consider themselves as owners, but only as occupiers of property.

The CHAIRMAN. What percent of value do you loan?

Mr. PALMER. We can loan up to 90 percent under our Federal charter. We are doing some 90-percent lending. Typically I would say it is very close to 80 percent throughout most of our territory.

The CHAIRMAN. And how many years do you give to pay?

Mr. PALMER. Twenty-five years is practically top. I think we might have a half dozen loans with longer terms than that.

The CHAIRMAN. Are they new homes or old homes?

Mr. PALMER. They are primarily new homes. Senator, I think one of the things that would astound any citizen if he were to make a tour through the country by car and get a chance to see all the kinds of towns I am talking about would be the amazing improvement in housing that has occurred clear across the face of this land.

In our type of institution, we are basically responsible.

Now, the life insurance companies, which are a source of mortgage credit in the metropolitan areas never come into these smaller communities. I think my bank is typical of banks and the loan demand from ordinary channels would prohibit us from lending more than a token amount in mortgage loans. Our small country bank is about a million and a half to a million and three-quarters in a town of 1,000 people. And I do not think we could absorb three or four mortgage loans in that bank and still carry on as we need to.

The CHAIRMAN. How much of your portfolio is FHA and how much is VA?

Mr. PALMER. I have currently about $5 million worth of VA loans and about a quarter of a million dollars of FHA. I have made altogether over 2,000 VA loans in my territory. We have been actively engaged in the Veterans' Administration loan program on a very large scale since 1946.

The CHAIRMAN. What class of loans have you had the greatest losses on?

Mr. PALMER. In the smaller communities?

The CHAIRMAN. I mean FHA, VA, or what?

Mr. PALMER. We do not have a loss on the VA loans—they are guaranteed. The FHA loans, however, of the kind that are being made now, where the downpayments are very low, because of our foreclosure requirements out there—it means about a 16- to 18-month delay before we get title—it could result in, I would say, typically, from a thousand dollars to two thousand dollars loss on any FHA loan that was made with a small downpayment. That is one of the reasons I have very few of them in my portfolio.

The CHAIRMAN. What percent payment down is that?

Mr. PALMER. We have only two that do not have 10 percent or more down. We can have, of course, as low as—we can make a loan with only a 3-percent downpayment on FHA.

The CHAIRMAN. But you do not do that.

Mr. PALMER. No. I have got risks that are all I want to labor under without doing that.

The CHAIRMAN. Well, thank you very much, Mr. Palmer.

Mr. PALMER. Thank you.

The CHAIRMAN. Our next witness is Mr. David C. McDonald, vice president of the Arkansas Savings & Loan League.

Please proceed, Mr. McDonald.

STATEMENT OF DAVID C. McDONALD, VICE PRESIDENT, ARKANSAS SAVINGS & LOAN LEAGUE

Mr. McDONALD. Mr. Chairman and members of the Senate Finance Committee, my name is David C. McDonald. I am vice president of the Arkansas Savings & Loan League, which represents every savings and loan association in the State of Arkansas.

During the year of 1961, Arkansas savings and loan associations increased their assets by $55,322,533, and increased their mortgage loan portfolio by $46,248,725. Also, during this same period, the associations in Arkansas increased their reserves $3,587,112, and made 5,729 loans, which totaled $58,074,952. During the 5-year period ending December 31, 1961, Arkansas associations closed over 25,000 loans and the Arkansas associations now have over 116,000 savers.

We realize that these figures are microscopic compared to the national totals, but to Arkansas, which is one of the poorer States, these figures are vital to our economy.

Savings and loan associations are not commercial banks and they do not want to be commercial banks. For the savings and loan industry to continue to prosper and grow it must add to its reserves from the meager profit it makes after dividend and expenses are deducted. Since most associations are mutuals (or cooperatives), unlike commercial banks, they are unable to issue additional capital stock to support growth.

Nationwide, the savings and loan industry finances about 45 percent of all home purchases. In Arkansas, the savings and loan industry finances the purchase and repair of homes in small communities that do not qualify for the rigid population requirements of most major life insurance companies. Since most commercial banks have not in the past been interested in long-term mortgages, we have been the only source of money in these smaller markets. We believe that it is just as important for a citizen who lives in a small town of 1,000 population to have access to good home financing as someone who lives in a metropolitan area.

There are two proposals in H.R. 10650 that pertain directly to the savings and loan business. First is the change in the method of taxation of savings associations. During 1961, Arkansas associations paid taxes of only $21,303. If the proposed formula of H.R. 10650 would have been in effect, the tax would have been $480,025, which is an increase of 2,153 percent. Although this amount of tax is minute compared to the national scale, it should be pointed out that it takes $1 in reserve to support every $19 of savings. This new tax formula, coupled with greatly increased competition from commercial banks, would greatly affect our lending ability. We of the Arkansas league believe that it would be in the best interest of Arkansas economy not to have the full tax imposed at once, but that a stairstep method be used.

Another feature of H.R. 10650 is the 20-percent withholding feature on dividends. We believe this withholding tax would greatly affect our business. It would add to the cost of our operation and may cause us some loss of savings accounts. Furthermore, because of the new automatic processing equipment that is being installed by the Internal Revenue Service, it would be unnecessary.

The CHAIRMAN. Thank you very much, Mr. McDonald.

Our last witness this afternoon is Mr. Irvin Marcus, on behalf of the Kentucky Building, Savings & Loan Association, Louisville, Ky.

We are glad to have you, Mr. Marcus.

STATEMENT OF IRVIN MARCUS, ON BEHALF OF THE KENTUCKY BUILDING, SAVINGS & LOAN LEAGUE, LOUISVILLE, KY.

Mr. MARCUS. My name is Irvin Marcus. I am president of the Jefferson Federal Savings & Loan Association, of Louisville, Ky., and appear here on behalf of the Kentucky Building, Savings & Loan League and its 100-member associations throughout the State of Kentucky. The dollar volume of mortgage loans outstanding in Kentucky, as of December 31, 1961, held by members of the Kentucky League was in excess of $900 million. In the calendar year 1960, more than 14,500 mortgage loans were made by Kentucky associations, with a dollar volume in excess of $171 million, and in 1961, more than 16,000 mortgage loans were made, having a dollar volume exceeding $206 million.

This statement will touch upon. (1) the effect of the interest raise on savings deposits in commercial banks; (2) taxation imposed by section 8, H.R. 10650; (3) anticipated effect of withholding.

(1) THE EFFECT OF THE INTEREST RAISE ON SAVINGS DEPOSITS IN COMMERCIAL BANKS

With the advent of the 4-percent commercial bank savings account, "growth funds" in our associations have sharply declined. A majority of the commercial banks in Kentucky promptly announced the raising of their interest rates and it is evident that our associations on a 4-percent dividend basis are unable to compete with them for savings at the increased bank rate. At the time of these announcements, around January 1, 1962, four of Louisville's Federal savings and loan associations were on a 4-percent dividend basis, and the others 4½ percent. The 4-percent associations have not been able to attract new savings in any appreciable amount, or to hold many accounts already on their books.

Figures from the Federal Home Loan Bank of Cincinnati, showing the net new money received by all Kentucky-insured associations in January and February of 1961, as compared with net new money received after announcement of the increase of the bank rate, in the same months of 1962, are quite significant. They are as follows:

Net new money received in—	
January 1961	$7,386,000
February 1961	7,022,000
January 1962	4,410,000
February 1962	4,770,000

One of Louisville's 4 percent associations has just announced the increase of its dividend to 4½ percent for the current semiannual period and another is giving serious consideration to similar action. There can be no further growth of Kentucky's 4-percent associations in competition with the increased bank rate on savings deposits. They are compelled to increase to a 4½-percent dividend basis to attract new savings into the home mortgage stream and, unless they do this, home construction and mortgage lending in Kentucky will decline even more than it has already. New residential starts in 1962 are below those of 1961, with no marked improvement in sight.

(2) TAXATION IMPOSED BY SECTION 8, H.R. 10650

Savings and loan associations are not commercial banks and it is fallacious to think of these mutual thrift institutions as being comparable to commercial banks for tax purposes. Savings and loan associations have been recognized as institutions chartered to encourage thrift and to promote the ownership of homes. It has been generally accepted that these thrift institutions differ from other corporations (including commercial banking corporations) in their purpose and nature, and it's because of this and because of the unique and important function they perform—that they have always been regarded as a proper subject to independent legislation designed to fit their character, purpose, and importance to the country.

They not only aid people to acquire homes, who otherwise might not be able to do so, but, in so doing, they are instrumental in creating millions of dollars of taxable property which is placed on the tax rolls of the communities in which they live.

I believe it to be an accepted fact of American life that nothing contributes in a greater degree to the prosperity, contentment, and patriotism of our citizens—and thus to the stability of the Government of the United States, than does homeownership, for which hundreds of thousands of persons of small means throughout the United States depend upon savings and loan associations.

The legal rate of interest in Kentucky is 6 percent and all mortgage loans are not made at this maximum rate. The narrow profit spread between the cost of money at the increased 4½-percent dividend rate forced on 4-percent associations by the increase in the interest paid on bank savings deposits, makes the corporate tax sought to be imposed by section 8, H.R. 10650, too burdensome for the safe and proper operation of savings and loan associations in Kentucky, which must also maintain adequate reserves against losses. All income of these associations not required for operating costs and maintenance of reserves is paid to our savers and investors, in whose hands this income is subject to applicable income taxes.

Under prevailing conditions, the additional corporate taxes that would be imposed under section 8, H.R. 10650, are entirely too stringent. These associations might be able to operate under a formula allowing a 75-percent deduction of net income, after dividends and other expenses, rather than the 60-percent as proposed, with 25 percent of such net income becoming subject to taxation instead of the 40 percent proposed. Under the alternate provision, 5 percent of loans outstanding would be more realistic than the 3 percent presently proposed.

(3) ANTICIPATED EFFECT OF WITHHOLDING

Adoption of the withholding provision would add additional substantial expense to the operation of our associations in which the margin of profit in Kentucky is quite narrow, as I have already pointed out, and would be another added burden to management. All insured associations in Kentucky on December 31, 1961, had a total of 311,879 savings accounts. The average amount per account was $2,449—less than $2,500. The dividend computed at 4 percent per annum would amount to less than $100 per year per account, and the withholding tax would be less than $20, if the dividend was computed semiannually. The time that would be required to explain this withholding to savers—many of whom must be dealt with by mail—would add to the already heavy workload at dividend time. It is positively frightening to think of withholding from dividends computed quarterly—in the light of the many small amounts involved.

I believe the adoption of this provision would result in so much confusion and misunderstanding as to cause savers to withdraw their money and seek other sources of investment. I have already touched upon the adverse effect a reduction in "growth funds" has upon funds available for housing. The savings public is easily confused and misled. It so happens that I know of an instance where one saver withdrew her funds from an association in February of this year, after reading in a newspaper about the withholding tax proposal. She needed the return on her money to live, and was not going to let the Government take away 20 percent of that return and deprive her of the use of it while she is compelled to fill out forms, unfamiliar to her, and to suffer the delays and other inconveniences with which, except for the withholding, she would not be bothered. This is not an isolated case. It just happened that, in this instance, the manager of the association was able to learn why she was withdrawing her money.

The proponents of this proposal must well realize that a great many people will not go to the trouble, or will not even know how, to properly compute the amount of dividend withheld from them and will not know how to properly complete the form for the return to them of money rightly theirs but which has been unjustly taken away. Nothing but chaos and confusion can result from the enactment of this proposal, which will do irreparable damage to our institutions.

It is only logical to expect any withholding to be an annoyance to savers in thrift institutions. It is very easy for them to withdraw their savings and take their money out of savings and loan associations and find an avenue of investment free from the irritating problems of withholding. It is my considered judgment that withholding will not only cause wholesale withdrawals from savings and loan associations, but that it will cause many people, who otherwise would come to us, to take their money elsewhere. I further believe that the end result of withholding will do very little to aid in the collection of any substantial amount of Federal income taxes that would not otherwise be paid normally and that the harm it will do to home financing will greatly outweigh any benefits of tax collection that might be squeezed out of it.

In conclusion, I respectfully submit that the cumulative effect of the increased interest depositors in savings accounts in commercial banks will now receive, plus the effect on savings and loan associations of the proposed increase of corporate taxes, plus the burdensome cost and chaos that will inevitably result from the proposed withholding, will be detrimental to our associations; that it will completely destroy their "image" as a good place for the exercise of thrift. May I suggest that serious consideration be given to the possibility that once the acceptance of savings and loan association, which now exists, is lost, it will not be regained easily, if at all.

I want to thank the committee for giving the Kentucky Building, Savings & Loan League the opportunity of expressing these views on this occasion.

The CHAIRMAN. Thank you, Mr. Marcus. That concludes our witnesses for today.

The committee will recess until 10 tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

STATEMENT OF NEW JERSEY SAVINGS LOAN LEAGUE RE SECTION 8 OF H.R. 10650—PROPOSAL TO INCREASE THE INCOME TAX ON SAVINGS AND LOAN ASSOCIATIONS

This statement is filed by the New Jersey Savings Loan League on behalf of its 351 member associations which collectively hold the savings accounts of 1.5 million people and the mortgage loans of 290,000 people.

The New Jersey Savings Loan League is opposed to section 8 of H.R. 10650 for the following reasons:

1. It is our judgment that the enactment of this proposal would seriously curtail the ability of the savings and loan associations in New Jersey to provide economical home financing and would, over a period of time, force a number of associations out of business. Local savings and loan associations provide a steady flow of home mortgage money through periods of both easy and tight money, because that is their field of investment. No other financial institution is so limited in its investment field.

2. Savings and loan associations in New Jersey are all of the mutual type without paid-in capital or legal authority to acquire paid-in capital and, therefore, can only create reserves necessary to maintain solvency from retained earnings. Section 8 would, in effect, destroy the ability of many associations to comply with the statutory requirements, established by Federal or State law, for minimum reserve allocations without a reduction in dividend rates to savers below the level paid by a number of other financial institutions also seeking over-the-counter savings.

Mutual savings and loan associations have no earnings which inure to the benefit of any private individual or individuals other than on liquidation, in which event they are distributed to all the savers pro rata and are taxable at that point. Reserves in mutual associations are not established to enhance the value of stock issued by the associations because no stock is issued. They are established solely for the purpose of absorbing losses. Thus, a tax on amounts placed in these reserves is not a tax on income, but a tax on potential losses.

3. There is no justification, in fact, for the slogan of "tax equality," and several leading commercial bankers in New Jersey have publicly disavowed support of the so-called tax equality argument.

The corporate taxes from a commercial bank arise almost exclusively from their commercial operations in which the savings and loan associations cannot engage. Comparing commercial banks with savings and loan associations is like comparing peaches with apples. They are entirely different in structure, purpose, and investment opportunity. They are privately owned stock corporations, in which retained earnings inure to the benefit of stockholders and create an appreciation in the value of their stock.

4. New Jersey savings and loan associations, chartered by law for the purpose of promoting thrift, homeownership and housing, are faced with the problem of developing the resources necessary to provide financing for the housing of a rapidly expanding population, which State agencies estimate will grow by 1 million people in the next 10 years.

The New Jersey Savings & Loan League respectfully submits that it is more important to consider steps that would encourage savings for this purpose, rather than actions which would tend to curtail or limit the flow of savings.

5. The New Jersey Savings & Loan League believes that it is the function of taxation to raise revenue, and not to direct by law the flow of savings money in a marketplace economy. They subscribe to the following statement of Mr. Joseph P. McMurray, Chairman of the Federal Home Loan Bank Board, which was included in his statement filed with the House Ways and Means Committee in connection with the matter of taxation of savings and loan associations:

"It is our opinion that if the savings and loan associations subject to our supervision are, by reason of substantive changes in tax law, to be assigned a lesser role in the Nation's economy; if their home-financing activities are to be substantially and permanently reduced, then that decision should be made directly and in specific terms by the Congress and not by the staff in the Treasury."

6. The proposal contained in the legislation adopted by the House is exceedingly complex and, if enacted, will make it extremely difficult and costly for many associations in New Jersey, because of their small size and limited staffs, to cope with the technical problems created by this complex section.

7. The above six paragraphs set forth the primary reasons for opposition to section 8 of H.R. 10650. We believe that H.R. 10650 fails to give equitable consideration to the problems of savings and loan associations in this area, which have been financing thousands of homes at the lowest interest rates prevailing in the country for home financing. We feel it fails to give consideration to the mutual nature of our operations and the very large number of small institutions in the State which have collectively done an outstanding job.

In New Jersey, there are 422 savings and loan associations. They range in size from $28,000 in total resources to one having $214 million in resources. One hundred and ninety of these associations have assets of less than $1 million. Ninety-six cents of each savings dollar, in the associations in the State, is invested directly in mortgages. The only reserves the associations have come from retained earnings. At December 31, 1961, they equaled 6.25 percent of assets.

For the year 1960, according to the Federal Home Loan Bank Board, net income was $4.40 for each $100 of savings. Expenses of operation of the associations were among the very lowest in the country at $1.10 per $100 of savings. The money market forces, at the present time, indicate that associations have to pay, in many areas of the State, a 4-percent return for savings, in order to hold presently accumulated savings and attract minimum new amounts. The imposition of the tax would, in many cases, make this impossible.

In New Jersey there is a very limited area for the increase in home mortgage financing by commercial banks (because of statutory ratios of mortgages to deposits), which already have 48.7 percent of their time-deposit savings invested in mortgage loans.

For the year 1961, State-chartered savings and loan associations in the State made a total of 47,460 mortgage loans with an average loan of $12,678. Ninety-eight percent of the total number of these loans were on the monthly payment, direct-reduction basis. Typically, it requires the savings of seven people to provide the funds for one mortgage loan. It is essential that the associations be permitted to earn sufficient amounts to pay a competitive return in order to raise these savings and at the same time to develop loss reserves.

Retained earnings are the only source of reserves for mutual savings and loan associations. Historically, until 1930, New Jersey associations operated under a concept which in effect require the distribution of all earnings with no maintenance of loss reserves. The depression of the 1930's quickly illuminated the fallacy of that concept and the resulting lack of reserves in New Jersey, was a

major contributing cause for a shrinkage in resources, from a high point of $1.2 billion to approximately $250 million in 1944 and a decline in the number of associations from 1,530 to the present number.

The dollar requirements for the future are impossible to measure or estimate, but any conservative finance manager knows that certain reserves must be maintained for unforeseen contingencies.

Just recently in New Jersey we have had an experience which shows the need for reserves resulting from the violent storm on the coastal areas. Many of our associations in those areas had borrowers who suffered substantial losses, which will reflect themselves to a degree in losses directly to the associations.

There is attached to this memorandum a schedule showing the reserve allocations which 93 associations in New Jersey could make if the tax law were applied in its present form.

We respectfully request that the committee, for the above-stated reasons, not adopt the provision of section 8 of H.R. 10650, and that the tax status of savings and loan associations not be changed.

COMPUTATION OF TAX SITUATION AS IT AFFECTS NEW JERSEY ASSOCIATIONS UNDER PROPOSALS OF THE HOUSE WAYS AND MEANS COMMITTEE, H.R. 10650

Ninety-three associations were selected at random from throughout the State with total resources amounting to $1.6 billion which is 52 percent of the resources of the insured savings and loan associations of this State. An analysis was made of their statements of income and expenses, dividend and reserve requirements for the calendar year 1961 and their growth and where a dividend rate change had been announced, dividends were adjusted to account for the change. From the computations on individual associations, we determined the amount that would be left over for reserves after giving consideration to the payment of taxes. The following table shows the distribution of these associations by the percent of net income which would be available for transfer to reserve accounts.

New Jersey insured associations classified by reserve allocations after proposed tax

Percent net income to reserves:	
0 and less than 2	4
2 and less than 4	1
4 and less than 6	7
6 and less than 8	8
8 and less than 10	18
10 and less than 12	22
12 and less than 14	11
14 and less than 16	9
16 and over	13
Total	93

Ten percent of net income is the basic statutory requirement for State-chartered associations in New Jersey. However, for many associations the 10 percent statutory reserve requirement is not adequate to permit compliance with the minimum requirement established by Congress for insured associations, where the law requires a reserve of 5 percent of savings 20 years after the date of insurance of accounts.

STATEMENT OF SAVINGS ASSOCIATION LEAGUE OF NEW YORK STATE RE SECTION 8 OF H.R. 10650, PROPOSAL TO CHANGE INCOME TAX STATUS OF SAVINGS AND LOAN ASSOCIATIONS

This statement is filed by the Savings Association League of New York State on behalf of its members. Our 191 members had assets of $3,934,455,130 on December 31, 1961.

The Savings Association League of New York State is opposed to section 8 of H.R. 10650. We submit the following reasons in support of such opposition:

1. The recommendations contained in the Treasury Department statement of July 14, 1961, would discriminate unfairly against mutual savings and loan

associations. To the extent these recommendations are in part embodied in section 8 of H.R. 10650, that section is inequitable, for the following reasons:

(*a*) Mutual savings and loan associations are not banks. They are mutual savings institutions, organized to encourage thrift and homeownership, operated as cooperatives for the benefit of their members, not for profit, and to serve the communities in which their savings and borrowing members live and work.

(*b*) Over the years, the courts have consistently recognized that mutual savings and loan associations are not banks. In a recent case (*National Bank* v. *State*, 101 N.W. 2d 245 (1960)), the Supreme Court of Michigan said: "The record in this appeal discloses that Michigan building and loan associations operate in a narrow, restricted field, are markedly different in character, purpose, and organization from national banks, and are not in 'substantial competition' with national banks."

(*c*) Recognition of this fact was made by the Senate when it provided in the Revenue Act of 1951 for an allowable deduction for additions to bad debt reserves, which are now embodied in section 593 of the code as applicable to mutual savings banks, domestic building and loan associations and cooperative banks. This constituted a finding by the Senate that the character, purpose, and organization of these mutual thrift institutions are so different from those of the commercial banks that the nature and extent of such an allowable deduction should be written into the statute, rather than being left to the determination of a single individual. (Incidentally, it was recognized by the Members of the Senate with whom we discussed its action that the objective of the act would be properly served, if the result were to channel what would otherwise have been excessive reserve accumulations into the tax stream, through increases in the amount of interest-dividends paid by these mutual thrift institutions to their members. And such has been largely the result.)

2. Although the losses incurred by mutual thrift institutions may theoretically be deducted on a direct chargeoff basis, this avenue is not, in point of fact, available to them.

(*a*) Losses that may be deducted as they occur, under the present code, includes the following catgeories:

I. Losses on loans that prove uncollectible.

II. Capital losses on the sale of assets, such as investment securities, Government or municipal bonds, and FHA-insured, VA-guaranteed, or conventional mortgages.

III. Capital losses on the sale of office buildings, or furniture, fixtures, and equipment used in normal operations.

IV. Losses on cash in closed banks, over and above insurance provided by the FDIC.

V. Fidelity losses, over and above the amount recoverable under surety bonds maintained.

(*b*) In recognition of their special character, mutual savings and loan associations are required by the supervisory laws and regulations of every State and of the Federal Government to set aside a portion of the earnings of every fiscal period in order to accumulate loss reserves sufficient to maintain their solvency and to protect their members from loss on their savings during depression periods. In general, such requirements continue in force until the amount so set aside in loss reserves range to from 10 to 15 percent of the total savings of the members in such an institution.

(*c*) Since the mutual savings and loan associations are required by supervisory statutes to set aside earnings into loss reserves, deductions on a direct chargeoff basis under the Internal Revenue Code are obviously not available to them. In this respect, they materially from the commercial banks, approximately one-half of which are reported to have elected to use the direct chargeoff method, rather than the reserve basis.

(*d*) Even if the statutory requirements for the setting aside of loss reserves out of earnings did not exist, as above cited, mutual savings and loan associations would find the direct chargeoff basis to be unfeasible because—

I. In the case of their mortgage loans, the length of the real estate cycle results in the bunching of such losses to the extent that, as sad experience has proved, outright insolvency could result where an adequate loss reserve had not been accumulated.

II. Losses in other category, while not cyclical in nature, are frequently so substantial that, if supervisory requirements did not call for the development of reserves, the resulting reduction in the rate of a particular interest-dividend credit could result in such a sharp demand for withdrawals as to close down a particular institution.

3. Particularly unrealistic is item III-(a)-2 in the Treasury Department statement of July 14, 1961, that "Rules of supervisory authorities establishing high loss reserves take into account loss contingencies and margins of safety which are not allowed under Federal income tax law for other financial institutions."

(a) Mutual savings and loan associations are materially different in character, organization, and purpose from financial institutions organized for profit, with capital stock outstanding and which, in consequence, are not subject to statutory supervisory requirements of the types above listed.

(b) The provision in section 8 of the pending bill, requiring mutual savings and loan associations to pay an income tax on portions of their additions to loss reserves that must be established and maintained by statutory provisions of State and Federal laws, will result in double taxation, for the following reasons:

I. As previously pointed out, the losses chargeable to such reserves could be deducted by the direct chargeoff method.

II. However, as above noted, mutual savings and loan associations, by the nature of their type of organization and the statutes under which they operate, simply cannot use the direct chargeoff method.

III. Hence, when they incur losses that are chargeable to their loss reserves, they will be using sums which have been accumulated after taxes—despite the fact that other types of financial institutions and business organizations may deduct such losses before taxes.

4. The recommendations of the Treasury Department, to the extent they are embodied in section 8 of the pending bill would have the practical effect of imposing a direct tax on thrifty savers in mutual savings and loan associations, as is hereinafter demonstrated:

(a) Organized not for profit and without capital stock, these mutual savings and loan associations disburse all of their earnings and have no taxable income left, after they have applied the full amount of their earnings to—

I. Payment of operating expenses.

II. Allocations to statutory loss reserves.

III. Payment or credit of interest-dividend to savings members.

(b) The imposition of an income tax on any additions to statutory loss reserves would require a mutual savings and loan association in the 30 percent tax bracket to set aside $1.42 for each $1 added to its loss reserves; while for one in the 52 percent tax bracket, $2.08 would have to be set aside for every $1 added to its loss reserves.

(c) However, since a mutual savings and loan association has no other income, such taxes (at the rate of 42 cents or $1.08 per dollar added to loss reserves, as the case may be) could only be paid by what would be, in fact, a direct assessment on every savings member, reflected in a reduction in the rate of interest-dividend that could run up to as much as one-fourth of 1 percent per annum.

5. It is not in the public interest that supervised financial institutions of any type should be subject to conflicting requirements arising out of different statutes and under the jurisdiction of separate branches of Government.

(a) The approximately 1,900 Federal savings and loan associations, chartered and supervised by the Federal Home Loan Bank Board, are mutual savings institutions by statute and are required to set aside a portion of their earnings in loss reserves by the provisions of section 5 of the Home Owners' Loan Act, or by regulations of the Board issued pursuant thereto.

(b) The approximately 4,500 mutual savings and loan associations whose accounts are insured by the Federal Savings and Loan Insurance Corporation, are required to set aside a portion of their earnings in loss reserves by the provisions of article IV of the National Housing Act, or by regulations of the Corporation issued pursuant thereto.

(c) An income tax imposed upon such amounts so set aside, and available only to meet losses that would be deductible under the code, is obviously inconsistent with sound principles of government, as well as subjecting such institutions to the payment of income taxes on losses, in contravention of sound principles of taxation.

(d) The provisions of section 8 of the pending bill would, moreover, operate as a substantial deterrent to voluntary additions to loss reserves by these mutual savings and loan associations. Existing statutes and regulations establish minimum requirements as to the allocation of a portion of current earnings to reserves for future losses and are designed to encourage voluntary additions at all times. Yet the provisions of section 8 would have an opposite or conflicting result, since every incentive would operate in the opposite direction, in order to hold the payment of taxes to a minimum. The result could well raise supervisory problems of substantial consequence.

6. The allowable deduction for additions to loss reserves now contained in section 593 is amply justified by the experience of mutual thrift institutions.

(a) Prior to passage of the Revenue Act of 1951, the supervisory authorities asserted the need, based upon their experience, of deductions to permit the building of loss reserves to 15 percent of total savings of members in any such institution. Out of action by both Houses and the recommendation of the conferees, the ratio of 12 percent developed.

(b) Although the records of closed or merged institutions are difficult to secure, there is ample evidence that mutual thrift institutions, whose prime investment is in mortgage loans, are subject to losses that may accumulate to such a ratio in periods of depression.

(c) The only important change that should be made in section 593 is to revise its coverage from a reserve for bad debt losses to a reserve for all losses, since such was what was in the minds of the supervisory authorities in the first instance and is a basic need for these institutions, as hereinbefore demonstrated.

*(d) An oversight in the drafting of the Revenue Act of 1951 should also be corrected, in that section 593 applies to mutual savings banks, to cooperative banks * * * operated for mutual purposes and without profit, and also to "domestic building and loan associations." It is obvious that the latter phrase should be deleted and replaced with "mutual savings and loan associations," consistent with the obvious intent.*

We respectfully urge the committee, for the reasons given above, to delete section 8 from H.R. 10650 and leave the tax status of savings and loan associations unchanged.

(Whereupon, at 4:45 p.m. the committee stood in recess until 10 a.m., April 13, 1962.)

REVENUE ACT OF 1962

FRIDAY, APRIL 13, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:05 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (the chairman) presiding.

Present: Senators Byrd (chairman), Long, Douglas, Gore, Williams, Carlson, Curtis, and Kerr.

Also present: Elizabeth B. Springer, committee clerk; Colin F. Stam and L. M. Woodworth, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

We are pleased to have Senator Howard W. Cannon as our first witness.

STATEMENT OF SENATOR HOWARD W. CANNON, U.S. SENATOR FROM THE STATE OF NEVADA

Senator CANNON. Mr. Chairman, I appreciate the opportunity given me to appear before this committee during the course of hearings on H.R. 10650, the tax revision bill of 1962. May I say at the outset that I do not envy the members of this committee the task which is before them. On the other hand, I do have a great deal of confidence in the judgment that I am sure will be exercised in the consideration of this important legislation.

While I do, of course, have some fixed views on various portions of this bill, my purpose today is not to discuss any of the tax provisions but rather to request that the committee add an amendment which would provide an additional exemption of $600 to any taxpayer for each dependent son or daughter under the age of 23 who is a full-time student above the secondary level at an educational institution.

(A copy of the amendment proposed by Senator Cannon follows:)

SECTION 21—ADDITIONAL TAX EXEMPTION

Section 151 of the Internal Revenue Code of 1954 (relating to deductions for personal exemptions) is amended by adding at the end thereof the following new subsection:

"(g) ADDITIONAL EXEMPTION FOR DEPENDENT CHILDREN ATTENDING SCHOOL ABOVE THE SECONDARY LEVEL.—

"(1) IN GENERAL.—An additional exemption of $600 for each child of the taxpayer—

"(A) for whom the taxpayer is entitled to an exemption under subsection (e)(1) for the taxable year;

"(B) who has not attained the age of 23 at the close of the calendar year in which the taxable year of the taxpayer begins; and

"(C) who, during at least 4 calendar months during the calendar year in which the taxable year of the taxpayer begins, is a full-time student above the secondary level at an educational institution.

"(2) DEFINITIONS.—For purposes of paragraph (1)—

"(A) CHILD.—The term 'child' means an individual who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer.

"(B) EDUCATIONAL INSTITUTION.—The term 'educational institution' has the meaning assigned to it by subsection (e)(4)."

SEC. 2. Section 213(c) of the Internal Revenue Code of 1954 (relating to maximum limitations on deduction for medical, dental, etc., expenses) is amended by striking out "subsection (c) or (d), relating to the additional exemptions for age or blindness" and inserting in lieu thereof "subsection (c), (d), or (f), relating to certain additional exemptions".

SEC. 3. Section 3402(f)(1) of the Internal Revenue Code of 1954 (relating to withholding exemptions) is amended—

(1) by striking out "and" at the end of subparagraph (D);

(2) by striking out the period at the end of subparagraph (E) and inserting in lieu thereof a semicolon; and

(3) by adding after subparagraph (E) the following new subparagraph:

"(F) one additional exemption for each child with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(f) (relating to dependent children attending school above the secondary level) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit."

SEC. 4. The amendments made by this Act, other than the amendments made by section 3, shall apply to taxable years beginning after December 31, 1960. The amendments made by section 3 shall apply with respect to wages paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act.

Senator CANNON. On March 1, I made an extended statement on the floor of the Senate pointing up what I feel is one of the major challenges facing this Nation at the present time. I would appreciate having your approval for the insertion of this statement in its entirety in the hearing record in order that all members of the committee can, as they have time, reflect on the information which I have accumulated to show the imperative demand we have to assure that sufficient numbers of American youth are trained in the scientific and engineering fields.

(The statement referred to appears at the end of Senator Cannon's prepared statement.)

As I indicated, the entire problem was given added emphasis by the recent accomplishment of Col. John Glenn and by his appearance before the joint Congress and its committees. Colonel Glenn epitomized an achievement which had involved the expertise and dedication of thousands of engineers, scientists, and technicians who had performed various functions to assure the success of his oribtal flight. Yet, in spite of the transcendency of this accomplishment it still remains that this Nation is faced with a severe shortage in numbers of qualified personnel to perform not only the space exploration functions, but the many and varied other achievements which must be obtained in years immediately ahead.

This need and this challenge has impelled me to support those measures which are aimed at the improvement of our educational program, and I have a still greater interest in assuring that we continue

to meet the mounting challenge. The amendment which I offer is not designed in any sense to provide a tax loophole. In that respect it is consistent with H.R. 10650 which aims at eliminating various possibilities of tax avoidance. Under my proposal, only parents of dependent children attending school on a college level will be entitled to the additional exemption. Children with private income will not be considered and neither will adults who may be attending school.

Mr. Chairman, in closing, I would say that the full educational need of this Nation cannot fully be met by the amendment which I offer; but, with this program as with every other, it is necessary that we proceed as we can, keeping always in mind the ultimate goal. I hope, therefore, that your committee will not only consider favorably the addition of my proposal, but also look to other areas of opportunity in order that the needs of our free society may be met.

The CHAIRMAN. Thank you Senator Cannon.

(The statement referred to is as follows:)

STATEMENT OF SENATOR HOWARD W. CANNON ON SPACE-SCIENCE MANPOWER PROBLEMS

Mr. President, just 10 days ago the first American flew in orbit around this Earth. Last Monday that man, John H. Glenn, Jr., stood in these Halls of Congress and said, "We are just probing the surface of forthcoming scientific advancement * * *." He told us that the length of time he had been connected with Project Mercury—some 3 years—had impressed him mainly with a sense of how "tremendous are the areas left to be explored."

Finally, in closing his address, John Glenn told us that "knowledge begets knowledge," that "exploration, knowledge, and achievement are only as good as our ability to apply them to future actions."

Remarks of this nature, although we have heard their like before, seem to have a special significance when spoken by a man such as Astronaut Glenn, a man who combines within himself a representation of America's highest scientific achievement together with a level of personal courage that still leaves most of us marveling.

John Glenn's use of the word "we" in describing his accomplishments was a great deal more than mere modesty; it indicated—as he said many times last week—that thousands of Americans working together were the essential ingredient in the success of this first orbital flight.

And it is true that for every John Glenn in orbit, there must be thousands of engineers, scientists, and technicians working on the ground. And if tens of thousands of men were required in order to bring about Glenn's accomplishment, how many more do you suppose we will need next year and the year after, when 5, 10, perhaps 25 American spacemen will have been sent aloft?

All of us in America have had a great lift of confidence and pride as a result of Glenn's accomplishment. He has proven to us that we have the ability to actually bring about the fantastic space accomplishments which only 2 or 3 years ago seemed like the wildest dreams. Since Glenn's flight, ideas such as a rendezvous in space, landing on the Moon, visiting Mars and the other planets have suddenly become much more real, much more immediate than they ever were before.

Yet, though we have the scientific and technical ability without a doubt, there is grave doubt as to whether we will have the quantity of scientific and technical manpower which such an effort will require.

I am not the first one to voice concern over this problem, but I am concerned that the American public—and perhaps some of the Members of this body—are not yet sufficiently alerted to the critical nature of the scientific manpower shortage. And without such an alertness, the necessary corrective actions are doomed to failure.

To place before you the immensity of the problem and the depth of the concern, let me mention a few of the sources which have called attention to this issue in the last few months.

Let me start off with the words of President Kennedy at his press conference on January 15. The President said "One of the most critical problems facing this Nation is the inadequacy of the supply of scientific and technical manpower to satisfy the expanding requirements of this country's research and development efforts in the near future."

The Engineers Joint Council has reported a steady decline in engineering enrollments. In 1950 the Nation's colleges graduated 52,700 engineers; in 1960, less than 2 years ago, the number dropped to 37,800.

NASA itself has already told us that they will need 13,000 more engineers and scientists over the next few years. Only this Tuesday the Senate Space Committee began hearings on satellite communications legislation which could lead to a demand for more engineers. The expanding activities of the Atomic Energy Commission will certainly increase the science manpower demand. Just where these people will be found is still unknown.

Secretary Ribicoff of the Department of Health, Education, and Welfare has called attention to the fall in the percentage of freshmen entering engineering colleges and has said, "The balance of brainpower may tip—and tip dangerously—against us if the Nation does not soon awake to the importance of education to the freedom of the Western World."

Dr. Jerome Weisner, the President's science adviser, has said, "It is time for a searching study and analysis of our technical manpower—its quality and utilization, as well as quantity—and its implications for public policy. Similarly, we must make careful assessments of the demands our expanding research and development programs, both public and private, will place on our technical manpower resources.

"The effective use of scientists and engineers is important for the individual as well as for the Nation. In my view, far too little attention has been directed toward determining how effectively the national pool of scientific and technical manpower is distributed among industry, Government and universities, or to gaining a better understanding of the technical manpower needs and practices of each of these sectors, and of the factors that influence manpower distribution."

The National Science Foundation, in a report recently published by Dr. Nicholas DeWitt of the Russian Research Center at Harvard University, has revealed a most disturbing series of comparisons in a major analysis of Soviet education which indicates that the U.S.S.R. is producing 2 to 3 times as many scientific and technical graduates yearly as the United States.

Just take a look at some of the comparative Soviet-United States statistics. In the Soviet Union about 57 percent of all 1959 graduates at the bachelor level were in the sciences and engineering, compared with 24 percent in the United States. The projected annual addition of professional engineering graduates in the Soviet Union is 125,000, more than three times that of the United States. The Soviets are constantly intensifying and increasing the time devoted to these subjects in secondary schools, and nearly one-third of all Soviet engineering field professionals are women, compared with 1 percent in the United States. Upward of 5 percent of the gross national product in the Soviet Union is spent on education, as compared with about 3.6 percent in the United States.

Moreover, the quality must also be considered. Dr. DeWitt's report states that Soviet professional education in most scientific and engineering fields is at least equivalent to, and sometimes more extensive, than in the United States or Western Europe.

All of this does not mean that we could or should follow the Soviet methods of producing scientists and engineers. The free American educational system may never, perhaps, match in pure numbers the output of a system that allows the individual no freedom of choice regarding his education, a system that is determined to turn out scientists and engineers in quantity at almost a complete sacrifice of the fields of the social sciences, the arts, and the humanities.

Nevertheless, the tremendous Soviet strides in this field, coupled with our own declining—or at best, static—output, cannot fail but be a matter of gravest concern to the Nation. We cannot help but sound the alarm over this situation, which is no less than a major threat in the long-run struggle between democracy and totalitarianism.

More and more it is becoming obvious—as we all heard the other day from Colonel Glenn—that science and technology are increasingly going to become the foundation of our national strength.

These are the reasons why I believe so fervently that we in the Congress of the United States should not let ancient prejudices or short-range motives cloud our thinking on the great issue of aid to education—whether we are talking about the postgraduate, the college, or the secondary school level.

The issue, to my mind, has long since transcended the arguments which used to preoccupy the debaters in years gone by. Even the long and legalistic arguments over the proper role of the Federal Government, though important, must now take second place to the realization that today a discussion of education is nothing less than a discussion of national survival.

The building of a classroom is equally important as the building of a battleship or a missile. This is stated not in terms of rhetoric or to express a high-sounding sentiment; this, in my opinion, is no less than a hard statement of fact. If we falter in our mastery of space, if we fail to maintain a preeminent position, that failure will be laid directly to the lack of an adequate supply of critically needed scientific and engineering manpower—and the classroom is the only place where this critical space-age item can be produced.

Yet even if we do manage, by some miracle, to refill our educational pipeline in the near future, we still must cope with the immediate shortage of trained technical personnel, which will be with us for at least the next 5 years—and probably 10. In order to do this there are some questions we must answer: What action is being taken by the Federal Government in response to the President's expressed concern over the shortage of scientists and engineers? What has the National Academy of Sciences done regarding a study of scientific and technical manpower utilization? How efficient is the roster of scientific personnel which the National Science Foundation is required by law to maintain? What do the professional and scientific societies think can be done to help us get the best possible use out of the technical talent now in our possession? How do present-day industry recruiting practices affect the optimum use of our scientific manpower pool? What is the effect of Defense Department procurement procedures on the careers and jobs of our scientists and engineers? What is the answer to the question regarding whether our technical manpower is properly distributed among universities, industry, and Government?

What about the use of scientific personnel in administrative positions? The Soviet Union encourages it; many American scientists object to it. What are the guidelines? How many scientists are wasting their talents on simple and routine operations, are being "stockpiled" by industry, while frustrations build up, knowledge fades, and opportunties are overlooked? Are we making adequate use of our nondegree technicians? Are we availing ourselves of opportunities to upgrade people in this category into full-fledged engineers or scientists?

In this last connection, NASA, for example, has explored a crash program of upgrading junior scientific and engineering personnel by encouraging them to take night courses or on-the-job graduate work. NASA itself subsidizes on-the-job graduate training.

Another, longer range, approach along the same lines is to convince industry and the universities that they must enter into a much more intensified cooperative partnership to provide half-time graduate education for employees.

As for the long-range solutions that should be examined, we have already hinted at most of them. First, money for our classrooms. The National Science Foundation calls for a total investment for science and engineering education rising from $2.1 billion in 1961, to $5.5 billion by 1970. We need to take a new look at the way we present science, engineering and mathematics courses in our schools and colleges. We must seek imaginative ways of encouraging the future generation of engineers and scientists. As an example, NASA's personnel work in such fields as "control and guidance systems, "energy conversion," "flight systems," and the like. These are the designations of the future, the ones that will appeal to the awakening student. Mechanical, chemical, or physical engineers—the old designations—are found distributed throughout these new areas.

We must do more, much more, to encourage women to enter the fields of science and engineering. We must develop new methods for discovering the gifted and creative individual in our schools, many of whom drop out too soon or remain undiscovered because of our over-reliance on sometimes faulty measurements such as the IQ or academic grades—measurements which several experiments are proving to be far less reliable guides than we once thought they were.

In this short discussion, I have just barely touched on some of the problems and ramifications which lie at the heart of our scientific manpower dilemma. All of the questions and programs which I have mentioned deserve a much greater degree of attention from this body.

It is my feeling that the Congress of the United States, by every means at its disposal, must alert Americans to the very real dangers which face us, if we do not drastically step up our supply and improve our utilization of scientific and engineering manpower.

It would indeed be a cruel turn of events if we were to loss our mastery in space or our general preeminence in science because of a lack of that "we" element of which Colonel Glenn spoke to us so proudly.

For Colonel Glenn has made us all aware that he and the other astronauts can do the task we have required of them. As a priority matter of national policy, we must see that these men in space are backed up by a scientific community of adequate size, and in quality second to none.

I intend to speak out frequently on these problems. It is not my desire to be one who merely views with alarm. It is, however, essential that we lay these facts concerning our scientific manpower gap before the public. In so doing, we not only provide information, but we actively contribute to a national awareness which will act as a stimulant to increase student enthusiasm for careers in science.

The CHAIRMAN. The first industry witness is Mr. Arlindo S. Cate, National Committee for Insurance Taxation.

Senator KERR. Mr. Chairman, I would like to state that this witness represents the viewpoint of some of my fine constituents in Oklahoma. I hope to be here to hear his testimony and that of some of the others on this agenda today, but I am compelled to be with another committee conducting some hearings on an important piece of legislation and, therefore, will not have the pleasure of hearing him and the others that I had hoped to be able to listen to in the hearings today, sir.

The CHAIRMAN. Take a seat, Mr. Cate.

STATEMENT OF ARLINDO S. CATE, CHICAGO, ILL., REPRESENTING THE NATIONAL COMMITTEE FOR INSURANCE TAXATION

Mr. CATE. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, my name is Arlindo S. Cate. I am a partner in the firm of MacLeish, Spray, Price & Underwood, with offices at 134 South LaSalle Street, Chicago, Ill.

I am here today as a representative of the National Committee for Insurance Taxation, to support the President's recommendation that mutual and reciprocal fire and casualty insurance companies should be taxed on the same basis as business corporations generally, that is, that they should be taxed on their total income, from both underwriting and investments, at ordinary corporate rates.

The National Committee for Insurance Taxation is composed of more than 500 stock fire and casualty insurance companies located throughout the United States.

This membership constitutes more than one-half of the total number of stock fire and casualty insurance companies.

Moreover, the National Board of Fire Underwriters and the Association of Casualty and Surety Companies, whose membership includes most of the remaining stock companies, have also urged equal taxation for mutual and reciprocal companies.

Mr. Chairman, I depart from my prepared statement at this point to say when I refer to mutual companies, I include unincorporated mutual associations known as reciprocal insurers.

Stock fire and casualty insurance companies have always been taxed in the same manner as corporations in other industries. Their underwriting gains and investment income have been subjected to full corporate taxation.

We see no reason why the mutual segment of our industry, which competes aggressively and effectively with the stock companies, should not equally be subject to full taxation.

President Kennedy has recommended that mutual companies be taxed on their underwriting profits as well as their investment income, substantially in the same manner as stock companies, and Secretary Dillon has testified before this committee in support of this position. President Eisenhower, in his last budget message in January of 1961, also drew attention to the need for equalizing legislation.

Section 10 of the House bill now before you represents a significant step in the direction recommended by the President. But the House bill would by no means achieve equality of taxation.

Moreover, it would introduce into the law two unprecedented provisions, which would operate primarily for the benefit of a few of the largest and most profitable mutual companies, to the severe competitive disadvantage of the smaller and less profitable mutual companies and all of the stock companies.

We see no justification for these two special provisions and, as stated by the Secretary, these provisions should be eliminated with the result that mutual companies be taxed in the same manner as stock companies.

The first of these two provisions to which we object gives mutuals a special 5-year tax deferral of a substantial portion of their taxes, and, the second provides for permanent deferral or forgiveness of a significant part of the deferred taxes.

Specifically, this is the way the deferral and forgiveness would work. Mutual companies would be allowed an annual tax deduction equal to 1 percent of claims incurred, plus one-quarter of underwriting gain, less dividends, to be placed in a special "protection against loss" account for a period of 5 years.

During this period if there were any year in which there was an excess of underwriting loss over taxable investment income, the excess would be deducted from the account.

At the end of 5 years the remainder of 1 percent of insurance losses and one-half of the 25 percent of underwriting gain provision would be taxed; the other one-half of the underwriting gain would be permanently deferred, that is, all tax would be forgiven.

Thus, in effect, there would be a perpetual 5-year tax deferral on part of the earnings of mutual companies plus complete tax forgivness on a part of this deferral.

The amount of the forgiveness would be greatest for the most profitable of the companies, less for the less profitable and none for the unprofitable companies.

The deferred account could not be added to when it exceeded 10 percent of current annual premiums earned, less dividends, but this ceiling is so high as to be almost meaningless and would steadily increase as volume grows.

For example, within 5 years, this ceiling would permit one mutual company at its present rate of growth to take $100 million out of its taxable income and, within 10 years, over $200 million.

The House bill affords clear recognition of the fact that mutual companies are engaged in business for profit and that they earn and retain profits.

They use these profits in whatever way seems best to their controlling managers, whether for compensation, or for growth of the business, or for effective competition with the stock companies.

The House bill recognizes that the mutual companies should pay a tax on their underwriting profits as well as on their investment income. What it does not recognize is that the mutual companies can and should pay full ordinary corporate taxes, and that they can do so just as easily as American business generally.

The report of the Committee on Ways and Means states that the special tax deferral and forgiveness are provided for the mutual companies because of "the special circumstances of the mutual companies."

The special circumstances are said to be that the mutual companies suffer from "lack of access to the capital market for funds with which to pay losses." This is the sole reason advanced for providing special tax benefits for them. However, we do not believe that this argument advanced by the mutuals can bear scrutiny.

The fact of the matter is that the mutual companies do have access to the capital markets, providing only that they be willing to pay for it. Stock companies, when they raise capital, pay the going rate just as anyone else has to pay for capital.

When a mutual company is started, it has the same need for initial capital as a stock company. This initial capital requirement is supplied, usually by its controlling managers, and is paid for by interest. But as soon as the mutual's retained earnings are sufficient, this capital is usually repaid.

Small mutual companies, in earning their working capital, have had and would, under the President's recommendation, continue to enjoy complete tax exemption. Small stock companies must pay income taxes from the very beginning.

The mutual companies also formerly had access, at no interest cost, to billions of dollars to pay extraordinary losses, by virtue of policy provisions permitting assessments against policyholders.

However, as mutual companies grew and built up surplus out of retained earnings, it became apparent that this assessment method of access to free capital had become no longer necessary. Accordingly, within recent years, in order to have even more competitive edge over companies with stockholders, they have voluntarily given up their access to this source of capital by eliminating provisions for assessments from 90 percent of mutual policies.

Their desire to seize a specially favorable competitive position is perhaps understandable. But how can they possibly come before the Congress and say that the taxpayers of the United States should now contribute free capital to their ventures in order to protect them agains possible extraordinary losses, when they have voluntarily surrendered their access to this capital in the interests of increasing their competitive strength?

In a word, the managers of mutuals want the best of all worlds. They want, without investment of their own, to compete aggressively against people who have invested capital in the insurance business. But they want to do that with capital which costs them nothing, not

only capital which they have already acquired and retained from their policyholders, on a tax free or preferential basis over the years, but also with further capital funds to be acquired from continued special tax exemption and forgiveness.

Mutual companies, as a group, have no need for increased access to free capital but those which would benefit most from the House bill need it least of all. There are approximately 2,500 mutual fire and casualty insurance companies in the United States.

For the year 1960 we find that under the House bill 2,200 of these 2,500 mutual companies, because of their limited premium volume, would have been either totally tax exempt or would have paid virtually no additional tax and consequently would have received no benefit from the 5-year and permanent-deferral provisions.

Of the remaining 300 larger companies, approximately 100 paid dividends in excess of their underwriting profits, and, therefore, would have paid less tax under full corporate taxation than they paid under existing law.

Surely they have no claim for relief. Only the remaining 200 most profitable companies which would have paid increased taxes—that is, only the largest, most competitive and profitable 8 percent of the mutual industry would have enjoyed most of the special savings of the House bill.

The picture is even worse when the allocation of benefits between these top 200 companies is considered. A study of 20 of the largest mutual companies, representing over two-thirds of of the premium volume of these 200, shows that, had the provisions of the House bill been in effect during the 10 years ended with 1960, 75 percent of the remaining balance in the tax-free account for those 20 companies would have belonged to 2 of them. These two would have had over $35 million left.

The balance in this "protection against loss" account at the end of 1960 would be, of course, only a small part of the story. During the 10-year period these 20 large companies would have deferred tax on over $140 million for at least 5 years and subsequently would receive permanent deferral, that is, tax forgiveness, on a substantial part of this.

Since most of the tax deferral and forgiveness benefits would go to 20 of the largest companies, we should examine the need of these companies, which write over one-half of the total mutual business, for any protection against extraordinary losses.

At the end of 1960, these 20 companies had surplus of about $850 million. Yet, in the preceding 10 years, only 4 of these 20 companies would have made any charges for underwriting losses against the proposed special loss accounts and these charges would have amounted to only $7.1 million.

The surplus of these four companies at December 31, 1960, was over $375 million, or over 50 times their underwriting losses. Accordingly, neither the 20 of the largest companies as a group, nor the 4 companies which had any chargeable underwriting losses, had the slightest need for a protection against loss account.

It should also be pointed out that even if there had been any need for these companies to set up a special loss account, these companies should certainly be required to provide for it out of income already

exempt from Federal tax, before seeking to deduct any further amount from taxable income.

These 20 companies had tax-free dividend and interest income during the 10-year period ending in 1960 of close to $200 million, an amount substantially in excess of the special tax exempt loss protection account provisions of $142 million for these years.

In other words, these 20 companies already had tax-exempt income 27 times the amount of the underwriting losses they would have charged to these accounts in the 10-year period.

They can hardly ask to have additional income exempted from tax before applying existing tax-free income to this purpose.

In other words, before a taxpayer can ask for special tax subsidy because of economic need, he should first show that he has applied his economic income to this economic need.

In this discussion, it is essential also to remember that the past 10-year period was not a good one for the fire and casualty industry.

Indeed, in the last 5 of the 10 years, the industry had some of the worst underwriting experience in its entire history. Stock companies as a group had no net underwriting profits.

Mutuals continued to show profits, but at a smaller rate than in good years. In a more normal 10-year period, with continued growth in premiums written and an always increasing mutual share of the total business, the special tax benefits afforded the mutuals by the House bill would constantly grow in size.

Moreover, since these benefits would operate most favorably for the companies with the largest profits, the concentration of benefits in the hands of the biggest mutuals would become highly objectionable and irrational.

The most inequitable aspect of the House bill is the provision for forgiveness of tax on one-eighth of the underwriting profits, if they are not absorbed by underwriting losses within the 5-year deferral period. This is a discrimination n[illegible] only against the stock companies, but also against the less profitable m[illegible]l companies.

By definition, the amounts to be forgiven are determined solely by underwriting profits after payment of all losses. The larger and more profitable the company, the larger the tax forgiveness.

The company advancing this proposal for tax forgiveness is the largest and most profitable mutual company in the country. It had net income of $71 million in 1960, and $62 million in 1961. Its underwriting profit after dividends amounted to $50 million in 1960 and $40 million in 1961. A 10-year projection of its underwriting profits shows that in addition to the benefit of the tax deferral, the tax forgiveness alone would probably exceed $56 million for this one company.

This projection is based on this company's underwriting profitability for the years 1960–61 and its established rate of growth for the 10 years ended with 1961.

During the 10 years ended with 1960, the mutuals and reciprocals, charging initially the same prices as the stock companies, had underwriting profits (before determining dividends) at a rate of 19 times as great as that of the stock companies.

The underwriting profits of the stock companies as a group during this period were about one-half of 1 percent of net premiums written. The comparable figure for the mutuals and reciprocals was 9.6 percent. The net income from underwriting and investments of the mutuals was $3.7 billion, or almost as much as the $3.8 billion of the stock companies, although the mutual companies wrote only slightly more than one-third of the premiums written by the stock companies.

With such a tremendous advantage in underwriting profitability, there can be no need for tax deferral or forgiveness. Their competition is extremely effective, as is evidenced by the constantly increasing percentage of the total insurance business which is being obtained by the mutual companies. Since 1946 the mutual companies have increased their share of the total fire and casualty insurance business by over 20 percent.

No one objects to their success or profitability, except to the extent they try to exclude themselves from ordinary income tax burdens paid by the rest of the industry and by American business generally.

I should like to emphasize that under the method of equal taxation recommended by the President, mutuals would be permitted full deductions for all dividends to policyholders. Since many of the largest and most profitable mutual companies pay dividends in excess of their underwriting profits, such companies would pay less tax than under existing law.

Moreover, under the President's recommendation, mutual companies would for the first time be able to deduct all underwriting losses from taxable investment income. In many instances this would reduce the taxes they now pay. The burdens of equality of taxation would impinge only on companies which retain profits from their policyholders.

We therefore urge on you the enactment of the President's recommendation, without the unwarranted deferral and forgiveness provisions of the House bill, so as to bring equality of taxation to all types of fire and casualty insurance companies.

Mr. Charman, I have attached to my statement three exhibits which I would ask to be included in the record.

The CHAIRMAN. Without objection the insertion will be made in the record.

(The exhibits referred to follows:)

EXHIBIT A.—*Stock, mutual, and reciprocal companies—Classified by size on basis of premiums written (before dividends to policyholders), 1960*

	Mutual and reciprocal			Stock		
	Number of companies	Premiums		Number of companies	Premiums	
		Amount	Percent		Amount	Percent
Under $75,000	[1] 1,671	$37,294,000	1	[2] 91	$1,451,000	
$75,000 to $300,000	[3] 373	57,622,000	1	[2] 63	10,270,000	
$300,000 to $900,000	[4] 157	84,421,000	2	[2] 99	60,050,000	1
Subtotal	2,201	179,337,000	4	253	71,771,000	1
$900,000 to $15,000,000	243	898,338,000	20	380	1,785,152,000	17
$15,000,000 to $50,000,000	49	1,257,504,000	29	83	2,356,724,000	22
$50,000,000 to $200,000,000	10	1,006,741,000	23	31	3,025,606,000	29
$200,000,000 and over	3	1,062,353,000	24	9	3,292,648,000	31
Subtotal	[5] 305	4,224,936,000	96	503	10,460,130,000	99
Total	2,506	4,404,273,000	100	756	10,531,901,000	100

[1] Fully tax-exempt under present and proposed tax laws.
[2] None of the stock companies would be tax-exempt under proposed or present law.
[3] None of these companies would be taxable on their underwriting income under the bill (H.R. 10650). None of the above 2,044 mutuals and reciprocals referred to in these two notes would have paid more tax under H.R. 10650 than under present law.
[4] Under H.R. 10650 these companies would receive a special additional deduction in determining the statutory underwriting income or loss. The maximum deduction would be limited to $6,000.
[5] Approximately 100 of these companies in 1960 paid dividends in excess of underwriting profits. Accordingly, these 100 companies would have paid less tax under H.R. 10650 than they actually paid.

Source: Best's Insurance Guide, 1961.

EXHIBIT B.—*Stock, mutual, and reciprocal insurance companies—Income retained in the business, 10 years ended with 1960*

	Stock	Mutual and reciprocal
Underwriting income:		
Net premiums written	$80,159,042,000	$30,101,069,000
Percentage	100.0	100.0
Deduct—increase in unearned premiums	$3,065,668,000	$1,035,424,000
Earned premiums	$77,093,374,000	$29,065,675,000
Deduct—claims and expenses	$76,679,624,000	$26,163,896,000
Underwriting income	$413,750,000	$2,901,779,000
Percentage	0.5	9.6
Investment income:		
Net income	$4,156,508,000	$1,058,405,000
Capital gains realized	$540,142,000	$42,036,000
Investment income	$4,696,650,000	$1,100,441,000
Percentage	5.9	3.7
Income before Federal taxes	$5,110,400,000	$4,002,220,000
Percentage	6.4	13.3
Federal income taxes	$1,275,366,000	$296,300,000
Percentage	1.6	1.0
Net income	$3,835,034,000	$3,703,920,000
Percentage	4.8	12.3
Dividends:		
Policyholders	$441,029,000	$2,767,296,000
Stockholders	$2,121,476,000	
Total dividends	$2,562,505,000	$2,767,295,000
Percentage	3.2	9.2
Income retained in the business	$1,272,529,000	$936,624,000
Percentage	1.6	3.1

Source: Best's Aggregates & Averages.

EXHIBIT C.—*Twenty of the largest mutual companies protection against loss account tax-exempt investment income, and surplus, 10 years ended with 1960*

	State Farm Mutual Automobile Insurance Co.	Nationwide Mutual Insurance Co. and Nationwide Mutual Fire Insurance Co.	Farmers Mutual auto	16 other companies	Total
Protection against loss account:					
Tax-exempt provisions—					
1 percent of claims	$15,546,200	$7,930,500	$1,205,000	$51,841,300	$76,523,000
25 percent of underwriting gain	28,746,000	8,687,200	1,718,100	26,321,100	65,472,400
Total	44,292,200	16,617,700	2,923,100	78,162,400	141,995,400
Charges:					
Underwriting losses [1]	4,905,800	223,500	1,657,900	315,700	7,102,900
Other charges	11,831,700	4,901,200	861,600	64,812,000	82,396,500
Total	16,737,500	5,124,700	2,519,500	65,127,700	89,499,400
Balance, Dec. 31, 1960	27,554,700	11,493,000	413,600	13,034,700	52,496,000
Percent to total	52.5	21.9	0.8	24.8	100.0
Tax-exempt investment income	$38,387,000	$10,435,000	$2,185,000	$141,457,000	$192,464,000
Surplus, Dec. 31, 1960	258,990,000	88,249,000	14,601,000	481,441,000	843,281,000

[1] Amount in excess of taxable investment income.

The CHAIRMAN. Any questions, Senator Carlson?

Senator CARLSON. I don't believe I have any.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Just a few.

When was the $75,000 exemption put into the law for the small mutuals?

Mr. CATE. It has been in there for many years, sir, I know it was there prior to 1942. I don't know the exact date.

Senator CURTIS. Do you think it was a reasonable move when it was put in?

Mr. CATE. It was a move to take care of the small companies when they were starting, and we raised no objection to it.

Senator CURTIS. But you thought it was all right when it was done?

Mr. CATE. Well, it was done for the purpose of taking care of the very small mutuals, and there are a great number of them, there are about 1670 companies that fall within that group, Senator.

Senator CURTIS. They are not in the automobile insurance business to speak of. They are primarily fire?

Mr. CATE. You are correct. I was going to say they are primarily, many of them, are the small county mutuals writing within a county. Many of them are assessment mutuals, they perform very fine service in that particular area.

Senator CURTIS. And the $75,000 figure was written in in 1942, how much would it be now?

Mr. CATE. I don't know. The House bill provides that same provision for these small mutuals. I might say they have not grown substantially, they account for less than 1 percent of the premium volume.

Senator CURTIS. Here is what it amounts to. It was put in there at $75,000 and if their premium income didn't reach that they didn't

have to file a report, because many of them have no paid officers. They have no legal department but if it goes a dollar over $75,000 they have to make a tax return. And, just the ordinary inflation, may mean that this section should have some attention paid to it.

Now, you spoke of the 20 larger mutuals. What type of insurance is their principal business, automotive or what?

Mr. CATE. Well, automotive and fire would include the bulk of it.

Senator CURTIS. And fire?

Mr. CATE. Yes, sir.

Senator CURTIS. Windstorms and storms that may sweep a wide area on occasion, is that a factor to be taken into account in what is an appropriate reserve of companies dealing primarily in rendering protection to our people?

Mr. CATE. There are—I would say the same thing applies to stock companies and mutuals alike. The stock and mutual companies write all forms of insurance. The stock companies compete with the mutuals, they compete with each other, the mutuals compete with stock companies and they compete with other mutuals so any windstorm or so forth that were to strike across the country such as the recent storms that we have had that have gone up the east coast, would affect all of the carriers be they mutual or stock.

Senator CURTIS. But it does affect different sized companies differently?

Mr. CATE. It could affect, for example——

Senator CURTIS. Someone who is writing insurance in 50 States, percentagewise, is taking less of a risk in providing protection against storms in a given area than someone whose geographical domain is much smaller, isn't that right?

Mr. CATE. That is right.

Senator CURTIS. Now, on page 79 of the bill, I note that there are different rules for charging losses to the protection against loss account applying to the dividend paying mutuals and deviated mutuals.

Are there any stock casualty companies which write insurance on a premium deviated basis?

Mr. CATE. There are stock companies that write on a deviating basis, there are mutual companies that write on a deviating basis, yes, sir.

Senator CURTIS. Are there large stock companies that do?

Mr. CATE. Yes, sir.

Senator CURTIS. Do different rules apply in the case of the stock companies, as to the deviated premium as against those that pay dividends?

Mr. CATE. No, sir.

Senator CURTIS. Do you have any comment?

Mr. CATE. My only comment is I don't see any reason for tax preference or differential there for this reason: a stock company may deviate from a normal initial charge, let's say they were to deviate 20 percent; instead of a $100 premium, they were to charge $80. A mutual company would deviate from the $100 by $20 and would charge $80; both companies would then be charging the same rate and they would then compute their profits after the deduction of their underwriting losses and so forth.

Whatever was left they would take over into their surplus.

Now, the things that we are complaining about is that when the stock company makes that transfer to surplus it is after the payment of 52 percent, the ordinary corporate rate, whereas in the case of the mutual it would not be after the payment of the corporate rate, and that is the basis of our objection here, and the reason for our support of the recommendation made by the Secretary that they be taxed in the same manner at ordinary corporate rates without these deferral provisions which are included.

Senator CURTIS. My admiration always goes to individual businessmen and to companies who take positions on public questions and who come in and testify.

I think that is good business and what I want to inquire about in no sense is to embarrass anyone or to put this whole insurance question in any light other than what the merits of the different contending parties contain.

I would like to know when we receive testimony of a committee, is this National Committee for Insurance Taxation, when was it organized?

Mr. CATE. That has, this committee commenced, oh, I would say 5, 6 years ago, 7 years.

Senator CURTIS. And in 1958, 1959, 1960 and 1961, they filed a report of their expenses and receipts in connection with legislation, did they not?

Mr. CATE. Under the Lobbying Act, yes, sir.

Senator CURTIS. Now, does that report indicate that 500 stock companies support this effort?

Mr. CATE. I don't recall whether 500 is shown in it or not.

Senator CURTIS. Could it be true that more than 90 percent of that money came from one company?

Mr. CATE. I don't know, I just don't know the answer. I know that a substantial part came from one company, I just don't know about the figure of 90 percent.

Senator CURTIS. You wouldn't know whether of the $349,000 reported, all but $2,000 came from one company?

Mr. CATE. I know that it is not correct, sir for the time the National Committee was in existence.

Senator CURTIS. That is not correct, but it might have been as much as 90 percent?

Mr. CATE. I just don't know.

Senator CURTIS. But it is substantial?

Mr. CATE. Yes, sir.

Senator CURTIS. Coming back to one other thing before I return to the deviating companies.

I notice throughout your statement you refer to the President's program and other witnesses refer to it as the Treasury's position.

Is there any difference in that?

Mr. CATE. No, sir.

Senator CURTIS. But the program submitted by the President in reference to the taxation of mutual insurance companies other than life, was the same as it came from the Treasury?

Mr. CATE. Yes. That was the President's message, he sent his tax message to the House of Representatives. Secretary Dillon appeared before the Ways and Means Committee on that, made his recommenda-

tion, made the same recommendation in his testimony in support of it. He appeared before this committee as you will recall, and advocated that all of these companies be taxed in the same manner at ordinary corporate rates without the deferral provisions as contained in the House bill.

Senator CURTIS. Now, coming back to the deviating companies, you compared the deviating stock companies with deviating mutual companies.

It would be helpful if you could make a comparison of deviating stock companies with dividend-paying stock companies.

Mr. CATE. By that you mean dividends to policyholders, I assume. Stock companies may deviate or they may not. Stock companies may pay dividends to policyholders or they may not.

Senator CURTIS. And that is done, both methods are followed.

Mr. CATE. Yes.

Senator CURTIS. Is it followed by some of the larger companies?

Mr. CATE. Yes.

Senator CURTIS. Now——

Mr. CATE. And it is also correct, Senator, that a stock company may deviate and a stock company, the same company, may even pay a dividend to policyholders.

Senator CURTIS. Understand, I am not censuring your operation. I have a bill here of 240 pages dealing with many, many subjects, and I want to get such smatterings of information as I can. But what I want to know is what is the difference in the tax consequences of a deviating stock company and a stock company that is nondeviating but passes dividends to its policyholders?

Mr. CATE. I don't think there would be any. Let's take the example that I just referred to.

You have a stock company that deviates, we will say, 20 percent, so it would then receive $80 as its initial premium. You have another stock company following your illustration, that charges the $100 and pays a dividend to policyholders, we will say, of $20. So at the end of the year, and assume that their losses and expenses were the same, the stock company that has deviated and the stock company that had paid a dividend would have the same net profit. The dividend of the stock company that did not deviate but paid the dividend would be entitled to a deduction for its dividends paid or declared, and then whatever was left in the way of profit would be taxed at 52 percent.

But in the case of the mutual companies, whether they be dividend or deviating, their objection is that their profit would not be taxed at the same rate.

Senator CURTIS. Now, of two mutuals, one that pays a dividend and one that deviates, what is the difference in tax consequences assuming the arithmetic is the same?

Mr. CATE. Under the President's recommendation I don't see any difference.

Senator CURTIS. No, under the House bill. Two mutuals, one deviates, and one pays a policyholder dividends—assuming the amounts were equal, is it the same tax consequence?

Mr. CATE. There would be consequences regarding this tax-deferral provision which we are objecting to. The tax deferral would have consequences as to where the dividends were charged.

Senator CURTIS. Would there be a difference there in the amount of tax paid?

Mr. CATE. I beg your pardon?

Senator CURTIS. Would there be a difference in the amount of tax paid? And I am comparing one mutual with another mutual.

One deviates and one pays a policyholder dividends; in the same year do they pay the same tax?

Mr. CATE. I don't know that they would. I don't see where that would arise. There would be some elements of deferral involved.

Senator CURTIS. You don't know whether they would pay the same tax?

Mr. CATE. I just don't know unless there was——

Senator CURTIS. Now, of the insurance written in the United States other than life, what is the grand total of all? How much business is there?

Mr. CATE. Approximately—for the year 1960, approximately $15 billion.

Senator CURTIS. $15 billion?

Mr. CATE. Yes, sir.

Senator CURTIS. What is that $15 billion?

Mr. CATE. Premiums.

Senator CURTIS. $15 billion in premiums?

Mr. CATE. Yes, sir.

Senator CURTIS. How much of that was automotive insurance, including the liability and casualty and property damage as well as on the cars? How much of it was written in automobile policies of the $15 billion?

Mr. CATE. That information is available. I don't have it right here.

Senator CURTIS. Well, give me a guess and then supply it.

Mr. CATE. I will be happy to supply it exactly. I would say probably half or conceivably more.

Senator CURTIS. It probably is more, isn't it?

Mr. CATE. I would say so. Probably more.

(The information referred to was later provided for the record as follows:)

Percentage of 1960 premiums represented by automobile insurance

Stock companies	38.9
Mutual companies	47.8

Senator CURTIS. Because people are paying more in automobile insurance than other kinds of insurance and we have a lot of automobiles.

Mr. CATE. It is probably more. I just don't have the exact figure but I will certainly supply it. It is readily available.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Gore?

Senator GORE. I notice on page 4 of your statement it is stated that the only reason given in the House committee report for treating mutual companies differently is—

lack of access to the capital markets for funds with which to pay losses.

Mr. CATE. Yes, sir.

Senator GORE. Do you think this is insufficient justification for treating these companies differently?

Mr. CATE. I certainly do. I do not think it is appropriate at all. The recommendation of the Secretary was that they be treated equally. Now, you don't go to the capital market to get funds with which to pay losses. That is the function which is served by the surplus of a company, that is why the companies accumulate surplus, to pay the extraordinary losses.

Now, if a stock company had heavy extraordinary losses it would pay them out of surplus. If its surplus were exhausted and it had to go out into the capital market in order to obtain funds with which to pay losses, I can hardly imagine a less attractive investment to offer to the public than to go out and say, "We have used up our entire surplus and we now need capital to pay extraordinary losses." It would be in desperate shape indeed.

Furthermore, Senator, the mutual companies have made over the years, their net income from underwriting, their underwriting gain has consistently been many, many times that of the stock companies, and with that underwriting gain it seems strange indeed that you should set up a protection against loss account for the types of companies that have the largest underwriting gain. It would seem that the stock companies would be the ones that would have the greater need for that since they have the less underwriting gain, but the stock companies are not asking for that but we are objecting to this provision for the more profitable companies for protection against loss accounts when they are the most profitable.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Cate.

Mr. CATE. Thank you.

The CHAIRMAN. The next witness is Mr. Ambrose B. Kelly, Associated Factory Mutual Fire Insurance Cos.

Mr. Kelly, will you take a seat, sir, please, and proceed.

STATEMENT OF AMBROSE B. KELLY, GENERAL COUNSEL, ASSOCIATED FACTORY MUTUAL FIRE INSURANCE COS.

Mr. KELLY. Mr. Chairman and members of the committee, I am Ambrose Kelly, general counsel for the Associated Factory Mutual Fire Insurance Cos. My office is in the Turks Head Building, Providence, R.I. I have prepared a very brief statement which I have filed with you, and knowing the pressures under which the committee is working I will depend on each of you to read the statement for yourselves and will limit myself to a very few brief remarks with reference to the problem of our companies.

We operate on a somewhat different basis from other insurance companies, using a premium deposit plan, and the bill which has been passed by the House and which is before you recognizes for the first time this different method of operation and makes provision for our taxation on the same basis as stock insurers with merely a modification to determine correctly the premium income of our companies in accordance with the premium deposit plan.

Because as a result of conferences that were held it was felt that this plan and the development of the earned premium under it gave some very small advantage to our companies, the bill was changed from the original draft proposed by Congressman Ikard to provide for an additional taxable income of 2 percent of our earned premium.

It was felt that this was complete compensation for any small advantage we might get from the use of our own method of calculating earned premium. In coming before you, I need only emphasize the fact that our companies do not fit into the same category as other insurance companies, and this has been recognized by the Ways and Means Committee in its preparation of this draft.

I am in the position, which is not that of most of your other witnesses, of saying that the bill as passed by the House is entirely satisfactory to the group of companies which I represent.

We feel that as the result of the careful consideration which has been given to our problem, and I might say we have been reasonably active in calling it to the attention of the various people who have worked on it, Treasury, the staff of the joint congressional committee, the staff of the Ways and Means Committee, we think that the bill as drafted handles our problem adequately and we, therefore, simply urge you to continue with reference to our companies the provisions which were incorporated in the House bill.

If there are any questions with reference to our operation or with reference to the application of the bill to us, I will, of course, be delighted to answer.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. No questions.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. One question. What is that difference in the operation, just in a nutshell?

Mr. KELLY. In a nutshell, we secure the capital which a company like ours needs to provide large capacity through a premium deposit which is collected from the policyholder, which is roughly 10 times as much as the expected cost of insurance, Senator.

In other words, each of our policyholders, if we anticipate on the basis of our experience that his ultimate cost of insurance with us would be $1,000, will be asked to provide $10,000 at the time the policy is written. These premium deposits, which we hold during the time the policy is in force, give us the underwriting capacity that we need for the large risks which we write, and these are hospitals, colleges, housing projects, and, of course, a large number of industrial risks.

Senator CURTIS. How much does it take to determine what your underwriting cost is; can you determine that on a yearly basis?

Mr. KELLY. We determine that every year, but we make the actual return of funds to the policyholder at the end of the policy term. Over 60 percent of our policies are written for a 3-year term.

Senator CURTIS. What can you invest that money in in the meantime?

Mr. KELLY. Well, we have, as we must, a diversified portfolio. We have to have in mind that the money has to be available to pay catastrophic losses so that we give, I think, more attention than perhaps other insurers to the need for having liquid investments.

We hold large blocks of Government bonds. We have a proportion of our investments in stocks so we will have a balanced and diversified portfolio. We are earning, I think, a little under 4 percent on our investments, which would indicate the conservative nature of our portfolio.

We do give our policyholders the benefit of our investment earnings in determining their costs. In other words, we add up our losses and expenses, Senator, deduct from those our investment earnings in order to determine how much, after making proper provision for future catastrophe reserves, we can return to the policyholder.

Senator CURTIS. The difference in yours is that you get the capital first rather than retain it as you go along?

Mr. KELLY. That is correct, Senator.

Senator CURTIS. As another mutual does.

Mr. KELLY. Our companies are quite old. The oldest of them is now a little over 125 years old. The youngest of them is approximately 75 years old. During this time, because they have been putting aside some funds for catastrophes and for surplus they have built up on top of the premium deposits some capacity through catastrophe reserves.

Very occasionally we have an incident or a year which reminds us of the need for such accumulations. A few years ago, for example, we had a single loss on a single fire risk of $14 million. We operate throughout the United States, and we, therefore, can often be hit fairly hard in the hurricanes which unfortunately have been so much a part of our recent underwriting experience.

Senator CURTIS. The House bill permits you to determine your own absorption premium?

Mr. KELLY. What the House bill does, Senator, is permit us in calculating our earned premium to take into account not the so-called statutory formula which is used by other insurance companies, but to take into account the amount we are going to return to the policyholder. We, therefore, set up the reserves for calculation of earned premium not on the so-called statutory formula but on the basis of the returns actually being paid by the company at the beginning and end of the taxable year.

Senator CURTIS. Does that give your companies the right to determine the amount of their own tax?

Mr. KELLY. Not the amount of their own tax, Senator. It gives us the right to determine how much we need from our policyholders to pay our losses and expenses. It is true with us, as with all other insurance companies, that if the amount we take from the policyholder is in balance or is less than the amount we need to pay losses and expenses we will not pay any tax.

For example, without being on this basis, Senator, there were 2 years, 1955 and 1957, quite recently, in which we suffered very sharp losses, one of them was the year in which we had this $14 million loss. We had hurricane losses in this period, we had a number of very large fire losses. In those years our companies actually drew upon surplus. The amount we retained out of the premium deposit was not sufficient to pay our losses and expenses and we made up the difference from surplus.

Our great complaint is that as the tax law now reads, we continued to pay full income tax in those years despite the fact that we had to draw substantially from surplus in order to make up for our underwriting losses.

Under the new bill, as it has been prepared by the House, in such a year in which we did not draw down enough from our premium deposit to pay our losses and expenses we would pay no tax. We are very conscious of the fact that ahead of us is a period in which there are going to be tremendous demands on underwriting capacity and we feel that the premium deposit system in itself will not give us all the capacity needed. We are now under pressure from business and from other institutions as well to provide more insurance. I was, for example, in a hearing held by the Atomic Energy Commission with reference to insurance on bridges and thruways within the last few weeks. One of the problems there is that the insurance business doesn't have enough capacity. We are not in a position to insure some of these properties today, even though we regard them as risks which meet our standards, because we do not have sufficient capacity to take care of the largest possible single losses.

So we have every intention, from the standpoint of good management, of adding to our surpluses in future years. We will not only deduct from the premium deposits we are holding the amount necessary for losses and expenses, but we will deduct additional amounts to add to our surplus to give us capacity in the future and those amounts will be taxable under the proposed bill.

Curiously, as is brought out in our filed statement, if we had been on this tax basis last year, Senator, which was from our standpoint a good year in which we added substantial funds to our catastrophic reserves, our taxes would have been substantially higher than they actually will be under the present law.

Senator CURTIS. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Kelly.

Mr. KELLY. Thank you.

(The prepared statement of Mr. Kelly follows:)

STATEMENT OF AMBROSE B. KELLY, GENERAL COUNSEL, ASSOCIATED FACTORY MUTUAL FIRE INSURANCE COMPANIES

The Factory Mutual Companies are a group of seven mutual fire insurance companies specializing in the insurance of large industrial and institutional properties. Their policyholders include many of our leading industrial corporations, together with colleges, hospitals, schools and housing projects. Prevention of loss through the application of specialized engineering and inspection service is a vital part of their service. Because of the large size of the risks insured they are always subject to a possible catastrophic loss, which, if it occurs, requires the withdrawal of large sums from surplus account.

These companies operate on a "premium deposit" plan which requires the policyholder at the inception of his coverage to make a premium deposit which is approximately 10 times his annual premium cost. This premium deposit is the same in amount regardless of the term of the policy. This "premium deposit" has no relationship to the premiums charged by other insurance companies. As these companies have no invested capital, these large premium deposits provide them with the underwriting capacity needed to handle the large risks owned by their policyholders.

The actual premium, or cost of insurance, is determined by the amount which must be charged against or absorbed from the initial premium deposit in order to defray the losses and expenses for the operation of these companies, plus a contribution to surplus or catastrophe reserve. Therefore, the actual premium

for any particular policy cannot be determined until such policy is terminated either by cancellation or expiration. The premium deposit does not in itself constitute income to these companies—it is the absorption from such deposit that is the equivalent of the earned premium of other insurance companies.

This plan of operation is completely different from that of all other fire insurance companies.

Mutual fire and casualty insurance companies, including the Factory Mutuals, were brought under the Internal Revenue Code on the present tax basis in 1942. Under this law, mutual insurance companies either paid tax on their investment income, or on 1 percent of their gross receipts—whichever develops the greater tax. Because the "premium deposit" plan results in large accumulation of assets, the Factory Mutual Companies have always paid income taxes on the basis of the regular corporate rates applied to their investment income. This tax basis completely disregards the actual operating results of the companies and in those years when these companies have suffered catastrophic losses from hurricanes, tornadoes or bad fires, they have paid taxes of from $1,500,000 to $1,700,000, despite the drains on their surplus as a result of their underwriting losses.

Under the present law, the Factory Mutuals have consistently paid a higher tax in relationship to their earnings and to their premium income than other fire insurance companies. For the period 1942 to 1959, as shown on an exhibit filed by the Factory Mutual Companies with the Treasury Department, the the Factory Mutual Companies had paid 5.51 percent of their actual absorbed premiums in income tax, while the stock fire insurance companies had paid only 2.38 percent and other mutual fire insurance companies excluding the Factory Mutual Companies, had paid only 1.47 percent.

The inequity of the present tax treatment was illustrated very clearly in the President's tax message, dated May 3, 1961. A table appearing on page 292 therein shows that whereas the Factory Mutual Companies in 1958 wrote 0.8 percent of the total premiums written by the fire and casualty industry, their portion of the industry's total tax bill was nearly double their share at 1.5 percent.

The Ways and Means Committee, after careful study of the problem by the staff of the Joint Congressional Committee on Internal Revenue Taxation, has made proper provision for the taxation of companies operating on the premium deposit plan. We hope that your committee will, in its turn, endorse these provisions so that they may be finally enacted into law, thus establishing an equitable basis of taxation for these companies. This is incorporated on pages 88, 89, and 90 of H.R. 10650 under the caption "Mutual Fire Insurance Companies Operating on Basis of Premium Deposits."

The corrective measure of the Ways and Means Committee would put the Factory Mutual Companies on a total income basis of taxation, requiring them to be taxed on operating results the same as their competitors. The proposed sections contain provisions to determine properly the earned premium under the "premium deposit" method of operation.

The Factory Mutual Companies, from the nature of their business, are subject to occasional catastrophic losses. For example, in 1955 they sustained a series of large fires which resulted in an operating deficit for the year of about $5,400,000, on top of which they were compelled to pay $1,600,000 of Federal income taxes, thereby resulting in a total loss of $7 million.

Contrariwise, during 1961 their losses were abnormally low, thereby permitting them to restore to surplus the amounts withdrawn because of operating deficits in prior years. Had the proposed tax basis been put into effect in 1961 they would have paid about $4 million on the proposed basis for that year, against slightly less than $2 million.

We urge the Senate Finance Committee to continue the provision in H.R. 10650 for the taxation of mutual insurance companies operating on the premium deposit plan, which were included in the House bill after careful study by both the staff and the Ways and Means Committee.

The CHAIRMAN. The next witness is Mr. John J. Wicker, Jr., of Richmond, Va.

Mr. Wicker, will you take a seat.

The CHAIRMAN. I want to introduce Mr. Wicker. I have known him for many years and he is one of the outstanding men in Virginia. He is a former State senator of Virginia and a member of the finance

committee of the State senate. He was the first chairman of the 1945 Constitutional Convention of Virginia. He is a fellow of the International Academy of Trial Lawyers. He is one of the original founders of the American Legion. He was former national chairman of the American Bar Association's section on insurance negligence and compensation law.

John, I have given you a good introduction and you can proceed.

Mr. WICKER. You certainly have, Mr. Chairman. [Laughter.] If you will just give the same commendation on consideration of our program when you all get to voting I will be very, very happy.

The CHAIRMAN. Proceed.

STATEMENT OF JOHN J. WICKER, JR., GENERAL COUNSEL, MUTUAL INSURANCE COMMITTEE ON FEDERAL TAXATION; ACCOMPANIED BY GEORGE HASKELL

Mr. WICKER. Mr. Chairman, and other gentlemen of the committee, I am filing with my formal statement some exhibits including lists of member companies in our organization and other pertinent information. To save time I will not read from the appendix or from the exhibits, but I trust they will be included in the full printed record.

The CHAIRMAN. Without objection.

Mr. WICKER. I am John J. Wicker, Jr., general counsel of the Mutual Insurance Committee on Federal Taxation. This organization, which I shall hereafter call the "Mutual Committee" is composed of 721 mutual fire and casualty companies with more than 27 million policyholders in all States of the Union, and the member companies range all the way from the smallest companies up to the largest companies, farm companies, assessment companies, postdividend companies, deviation companies, automobile companies, fire companies, every type of mutual.

I believe we contain in our membership approximately 97 percent of the taxpaying mutuals of the United States.

As I say we are filing with our statement a list of our companies. I don't believe that was done by the first speaker today. I trust he will do it. It would be very interesting.

There are only 45,500,000 families in the United States. A substantial percentage of all families have one or more mutual policies. I represent 27 million policyholders here, a great many of them business people. As you can see, the families of the United States are interested in the welfare of these mutual companies.

The mutuals I represent were referred to by Secretary Dillon before the House as "regular mutuals." We think that is all right. That is to distinguish them from "factory mutuals," whose spokesman you have just heard from and from the "reciprocals," whose spokesman you will hear from later on today.

Their structure is different and their problems are different and so they have necessarily different speakers.

I am here today in opposition to certain parts of section 10 of H.R. 10650. Now that bill contains some principles of taxation that we can accept. It does recognize the fact that there is a vital difference between our mutuals and the stocks. It recognizes the fact, the

principle, that if you are going to take away our right to add to our protective policyholder surplus the underwriting balance that we may have left, whenever we have any left, if that is going to be taken away or the most of it, by 52-percent taxation, then something reasonably equivalent must be supplied in its place. The House bill recognizes the principle but then it undertakes to supply a very inadequate substitute, something it calls a "protection-against-loss account," PAL. I am not facetious when I say that it might better be referred to as a SOH account, sleight-of-hand, because it gives to you with one hand and takes it away with the other.

Now you see it, now you don't. That is not a facetious statement at all.

As it stands, the bill does not promote competitive equality, but, in fact, would handicap the mutuals in the competitive market. In place of the present tax system, here is what the House bill would do. It would keep the $75,000 exemption for very small companies unchanged although everybody knows if $75,000 was reasonable for exemption limit for the very smallest mutuals in 1942, that exemption limit should be raised to at least $150,000 today to be equivalent to what it was in 1942.

Next, the bill takes the next group of small mutuals; that is, those with gross income ranging from $300,000 up to $900,000 and allows them an option, a restricted option, of paying taxes on investment income only.

All other mutuals with gross receipts from every source above $900,000 would be taxed for the first time on total income; that is, they would be taxed not only upon investment income but also upon the premium income that comes in from the policyholders.

Now, the bill undertakes to modify total income taxation, recognizing the principle of the need of special loss reserves for the mutuals, by what the bill calls a protection-again-loss account. Each year, 1 percent of losses each year, incurred losses, actual losses, and one-fourth of any underwriting gain—that is, anything you have left over out of premium receipts after payment of losses and expenses—would be set aside in a protection-against-loss account; a special loss fund.

However, the bill puts a cumulative ceiling of 10 percent of earned premium volume on the loss fund and a "force out," on it every year after 5 years. Both of those we think are unreasonable, unnecessary, inequitable, and nullify largely the effectiveness and the good of the loss fund.

The very intent that the Ways and Means Committee had in mind according to its report—and we are in accord with that intent—is not carried out.

Losses go way up and way down. The 10-percent ceiling would mean you couldn't add anything whatever to the loss fund in a good year or even in a year of tremendous heavy losses whenever such addition would increase the fund $1 to a point above 10 percent of your current net premium volume. The loss fund couldn't go up when you ought to add in the good years to help protect against the bad years. The Bible urges that in years of feast, you put something aside for the years of famine. The bill says you cannot go above the 10 percent, but there is no floor. The bill does not provide any floor that you can't go below.

Furthermore, the bill requires an annual "force out" from the loss fund after 5 years. There is nothing sacred at all about this arbitrary 5-year limitation. We checked the records. In some companies this "force out" would occur in years when it should be increased rather than depleted—in some companies this fund or account would be exhausted in the first year, in others the second year, in others in various years. In many cases, if ordinary losses are charged against this loss fund it would go right out for ordinary current losses instead of being held available as emergency protection against excess losses.

The special provisions for small mutuals provided in the bill are completely inadequate for them, and the concentrated risk mutuals should have a more realistic allowance than the bill grants.

When the bill was before the Ways and Means Committee, we were asked to confer with the staff and to try to work out a plan that would do three things: One, would provide the Treasury with substantially increased revenue, placing the mutuals on a modified total income approach basis. That was one thing.

Secondly, that would recognize the principle of the difference between mutuals and stocks and provide an appropriate modification.

Third, that would provide for an equitable redistribution of the tax burden between mutuals so that those more able to pay would pay more, and those less able to pay would pay less. That we did. We submitted a reasonable plan that met all three requirements. The facts were all checked very carefully by the staff of the Joint Committee on Internal Revenue, as presented, and we hoped that our plan would be approved.

Unfortunately as one member of the staff succinctly remarked right after the Ways and Means Committee's final action.

"Yes, they approved the form of your mutual plan but not the substance." In addition the gimmicks of the 5-year "force out" and 10-percent ceiling they put in, and a proviso that mutuals must exhaust this emergency loss fund whenever current policyholder dividends, current expenses, and current losses exceeded current premiums before using any part of current investment income. Obviously current receipts from current investment income are just as much a part of current assets and current receipts as premium income.

Now here is what we proposed in our plan. Our plan provided for a loss-fund account made up of one-fourth of underwriting gains if any and 1 percent of incurred losses. To that extent it was just the same as the House bill.

However, we provided that this special loss fund would be used only in tax loss years as an offset to any excess of total losses, expenses, and dividends over total taxable income.

We recommended that mutuals with less than $150,000 gross receipts would be exempt.

Also that small mutual—those with annual gross receipts under a million dollars—be given an option of taxation upon investment income only; and the additions to the loss fund be liberalized for those mutuals with annual gross receipts between a million and 5 million.

In the insurance world a company with gross receipts of less than $5 million is not a large company at all. Such companies are not the smallest but they are medium-small companies and they need some liberalized provisions.

We recommended that the special provisions for concentrated risk mutuals be expanded realistically.

Now, that is what we offered. If this committee sees fit, as we hope and trust, to approve it, and adopt it, and it becomes law, it will increase the revenue to the Treasury right away by from 40 to 50 percent of what we pay under existing law.

I don't believe that you will find anywhere, certainly in the last 20 years, where any substantial taxpaying segment of the economy has been subjected to a tax increase of more than 40 to 50 percent. I doubt if you will find any as great.

The House bill, instead of that, would double our taxes, double them, and I notice the Secretary of the Treasury came in recently before your committee and urged that the House bill be more harsh. He wants to add still more.

Now, as you know, under the present law mutuals, except the very, very small ones accounting for less than 2 percent of the business, have paid taxes each and every year. All except the very small exempt mutuals have paid each and every year, either full corporate rates on their entire taxable investment income including their realized net capital gains, or 1 percent of their gross receipts, less policyholder dividends, whichever alternative produced the higher tax.

Those taxes have risen from under $6 million in 1942 when the existing mutual tax law was passed, to more than $41 million in 1960.

Now, the present law hasn't favored the mutuals group at all, because the record shows that in that period even though our underwriting income has been tax free we have been able to increase our policyholder surplus by only 5.54 percent of net premium volume, while the stock companies as a group have been able to increase their surplus by nearly 7 percent—6.76 percent—and that hasn't been excessive in either case. And we haven't unduly increased our share of the market.

In 1942, these mutuals wrote about 20 percent of total premium volume; 20 years later, today, they write only about 25 percent. That is a modest growth, and it can't fairly be attributed to the income tax law.

For example, consider the experience of Allstate Insurance Co. which is the chief mogul of the so-called national committee, chief antimutual propagandist. That is a stock company taxed on the stock basis. Since 1942 that company has increased its surplus from a little over $3½ million up to $225,741,000.

Its premium volume has increased from about $5½ million up to over $495 million. So when Allstate comes in compaining about alleged tax inequality and that the mutual tax law puts it under a competitive disadvantage, it is like a man bulging with fat, with food coming out of his jaws and money running out of his pockets, complaining because somebody across the street there had a sandwich.

Allstate and its stock associates have prospered tremendously, and the mutuals have not prospered unduly.

As a matter of fact, this proposal for abolishing the existing mutual tax law and substituting a total income approach has been agitated and principally promoted by the Allstate Insurance Co. which is said to be the most prosperous of all stock companies. They have agitated that for years, they first did it in their own name. They went before

the House Ways and Means Committee with brochures something like ours and a lot of charts in their own name in 1953, 1954, 1955, 1956. Then when it was pointed out how prosperous they were, they then got a front organization and came out with a letterhead, "National Committee for Insurance Taxation."

Well, the lobby records officially filed reveal that that National Committee for Insurance Taxation—all stock companies—in the last 4 years has collected and spent in lobbying purposes against the mutuals $351,000. And that of that amount, this one company, out of the 500 they talk about, has contributed 99.42 percent of that, specifically has contributed $349,879.

Now, perhaps you will understand why I refer to this national committee as a "front" for the Allstate Insurance when Allstate controls that and finances it so lavishly.

I have nothing against that in any way, and I certainly have nothing against the sole stockholder of Allstate, it is a very fine company, Sears, Roebuck.

(Discussion off the record.)

Mr. WICKER. Now, the mutuals need funds free of tax to make up for their lack of access to the equity capital market which access is available to stock companies.

All insurance companies, both stock and mutual, now maintain for the protection of their policyholders an adequate fund called policyholders surplus. This is what makes insurance possible. It is the cushion which absorbs the inevitable ebbs and flows of losses paid to and on behalf of policyholders. Surplus protection must be increased generally in proportion to increases in insurance provided. Hence, the ability of an insurance company to maintain insurance protection and service its customers in an expanding economy depends upon its capacity to keep its policyholders' surplus abreast of the increased protection it must afford.

So unless mutuals can continue to modestly increase their surplus in keeping with the expanded economy, they are going to fade out of the picture.

During the last 10 years alone the stocks have added $5,278 million to their policyholders' surplus funds. About one-fourth—and this is very important—about one-fourth of their additions to their surplus have gone in tax free from the capital market. And about the same proportion has gone into mutual surplus tax free, not from the capital market but from underwriting which this bill now proposes to tax at 52 percent.

So you can understand our alarm when the excess that our competitors have is left untouched, as it properly should be left untouched, but we are being cut down about half.

If we had been able to outstrip them heretofore and build up a greater surplus it would be different. But we have not, as our files and exhibits here show. And the record shows, I say, our additions have been no greater than theirs; in fact, not quite as great.

Now, the impossible situation which this places the mutuals in can easily be demonstrated by visualizing the problem of a mutual company wishing to acquire funds from policyholders to improve its financial condition or increase its surplus or to comply with license requirements, and they are growing in every State.

The need for such periodic additions to surplus occurs among all companies, large, small, stock, mutual.

For example, within the last 4 years, two of the largest stock companies, one of them All State, have each added $50 million, $50 million each, from the equity capital market to strengthen their surplus and financial statement.

If a mutual company had to add $50 million to surplus funds under the House bill, where could it get it? They have no stock to sell. They could only get it from increased premiums. Under the House bill they would have to take in nearly $92 million, overall loss and expense requirements, in order to do what the stocks can do, and have done by selling stock to their stockholders and sometimes to their sole stockholder.

Some States have laws which allow a mutual company to meet surplus requirements on a tax-free basis through securing paid-in guarantee funds, but they are merely borrowed funds rather than equity capital. That has been tested out in court.

The U.S. Tax Court and others have held they are nothing but borrowed capital. They can merely be repaid. They are merely a subordinate loan called at the option of the company, with interest limited by law, and anyone who puts in anything when a mutual is started in guaranty capital, can never get $1 more than he put in. If he put in $100, no matter what happens, he cannot get back $103 or $105.

It is called, and he gets back only $100, and he only gets that back after everything else is satisfied and, in most States, with the permission of the insurance commissioner.

Sometimes, they say, "Oh, yes, mutuals have access, why, they have gotten millions of dollars, millions of dollars from the capital market."

What they are talking about is, well, it is so negligible you need a magnifying glass to see it. It is less than 7 cents per $100 of premium written. That is less than one-tenth of 1 percent, less than one-tenth of 1 percent of the surplus, this guarantee capital so-called represents. That is about as negligible and de minimis as you can think of.

Now, it has been claimed, and there is some very remote possibility, that without some overall size limit the loss fund, the special loss fund, of the mutuals might become excessive; that is why they say that we ought to have a forceout, we ought to have a ceiling.

We made a study of the 20 largest mutual companies. They account for about three-fifths of the mutual premium volume, and the average size of the loss account, without limitation, would have been only 5 percent of premium over the 10-year period. It averaged only 5, but in some years it would go way up above 10, and some years down to zero, and could go below even, but when you put a 10 percent constant ceiling on top, you do not allow them to go up as high as they should go in the good years in order to provide for the bad years.

Now, the committee's bill, the House bill report, says:

> Your committee's bill does not impose any overall ceiling on the amount which may be accumulated by a mutual savings institution with respect to its reserve for losses on qualifying real property loans. However, your com-

mittee intends from time to time to review the status of this reserve to be sure that the balances maintained in these reserves remain reasonable in light of the overall requirements of the mutual savings institutions.

They said that in referring to savings, mutual savings, institutions in the same bill, section 8 of the bill before you. The House bill, you see, provides for a special loss fund of 60 percent of tax, 60 percent of the tax, that can be set aside as a special loss fund, without ceiling and without a force out.

The Secretary of the Treasury before you gentlemen the other day said he wanted that cut down to 33⅓, but even he did not ask that there be any force out or any ceiling on them.

We would have no objection in the world to having the Ways and Means Committee maintain the same time-to-time review of the status of our loss funds, and if they proved at any time to be unreasonable, corrective legislation can be put in, and put through. And I can tell you if I am living and still counsel for this organization, and I expect to be, the Lord helping me, we won't object to anything like that. We would be perfectly willing to agree to anything like that.

We do not want anything unreasonable, but we do want to be treated reasonably and equitably the same way you have treated life companies and the same way in this present bill the mutual savings institutions are being treated; and they are being treated right.

In the life insurance tax law the Congress has granted to the mutual life companies, 50 percent of underwriting, and 50 percent of a portion of investment income in addition, set aside in a special loss account. That has no force out, and no ceiling in the case of a mutual life company.

It does have a ceiling in the case of a stock life company, and of course it does come into the tax picture if it goes for stockholder dividends.

We think the unrestricted loss funds for mutual life companies and mutual thrift institutions are proper and they are right. But we say that just as long-term protection of the participating owners and the peculiar nature of the risks of such institutions warrant no restrictions as to size or time on special reserve accounts for the mutual life insurance industry and mutual savings institutions, the special circumstances of the mutual fire and casualty industry warrant similar treatment.

Now, we say this "Protection against loss" account in the House bill is inadequate. Why? Well, we had our actuaries take the records of the mutual companies and take the decade of 1951 to 1960, which is a pretty good decade. It had loss years, and gain years, war years, peace years, fat years, lean years, every kind of year, a pretty good representative decade. We said, "Suppose this House bill had been in effect instead of the existing law; suppose it had been in effect, what would have happened."

Well, with that 5-year force-out provision, the loss account would seldom have been adequate to cover the period of heavy losses.

In 1956 and 1957 the industry suffered consecutive years of substantial underwriting deficits, and 1958 was just about break even.

Now, these disastrous years in a row clearly show the jeopardy which all mutuals would be subjected to under the proposed bill.

If additions to the loss fund had not been allowed to accumulate without limit or forceout, the protection against loss funds developed

by moderate addition over a 5-year period would be quickly dissipated just at the time when they would be most necessary for the purpose for which the fund was designed.

As a matter of record, within the last 10 years, 2 of the 20 largest companies went through consecutive 3-year periods where their total operating deficits—all outgoing items over all incoming items, including investment income—were in excess of 10 percent of 1 year's total earned premium. Yet this bill would put a ceiling on them.

If this can happen among the larger companies, the possibilities are obvious that successive year deficits of smaller and less diversified mutual companies can run substantially higher than the suggested 10 percent overall limit of the protection against loss account.

If you remove the time and size restriction that does not change the concept of tax on total income not a bit. The House bill in the Ways and Means report stated the principle well. They said:

> This accumulated underwriting income constitutes its reserves out of which insurance losses can be paid, and the existence of such reserves is an important protection to the mutual policyholders.
>
> Eventually, these companies will pay tax on their total income, but the tax-deferral formula of the bill gives recognition to the mutuals' lack of access to the capital market for funds with which to pay losses.

Thus, the bill recognizes that the mutuals have a special need. But if the special provisions in the proposed bill fail to achieve the aim of providing a substitute for the mutuals' lack of access to the equity capital market, then it does no good merely to recognize the principle. With these gimmicks in there, the principle, as I say, is largely nullified.

Now, this bill, strangely enough, actually discriminates between mutuals—not only between mutuals and stocks, but it discriminates by a provision in there against mutuals that retain the policyholder dividends at the end of the year.

Incidentally, someone asked, what proportion they are. In the mutuals I would say that the proportion of those who pay dividends at the end of the year is about two-thirds, around about, say, 60 to 70 percent. I am talking about volume of business, not number of companies.

Of the volume of business of those who deduct the dividends in advance and give the benefit of the savings to the policyholder in advance, that would run somewhere between around one-third, 30 to 40 percent.

In the stock companies, the participating people, whether dividend or deviation, would run about 12½ percent; much smaller percentage.

The discrimination between the two types of mutuals, that this bill would set up, is all wrong because that would have the effect then of the Congress trying to tell management whether they would operate on an advance dividend or deviation basis or on a postdividend basis; and Congress, I am sure, does not want to do that. Consider a company that wishes to use a $85-price for a unit of insurance coverage. It has had experience and says, "We think we could do business probably on $85, we hope."

All right. It can charge $100 and then return $15 as a participating dividend at the end of the policy period, or elect to charge only $85, and have no participating dividend.

Both the stock companies and mutual companies use both methods at one time or another. Some of them use both methods. Some companies will write one type of insurance on participating dividends and some on a deviation basis. The choice is one that ought to be properly within management discretion and should not be influenced by any tax law provisions.

For any individual company using either method there will be good years or bad years. Both of them not only try to retain but they have to retain some underwriting gain in good years to offset the underwriting loss of bad years.

Although the net price may be comparable on a participating or nonparticipating basis, there is a provision in section 10 of this bill, 824(d) (1) (A) which produces the amazing result of greatly reducing the effect of the protection against loss-account provisions for participating companies, that is dividend companies, compared to the treatment of deviation companies. Now, that is material.

Why is it material? Well, one of the Senators asked a question of Mr. Cate, I believe, as to whether there would be any particular tax significance.

In the appendix to our statement, you will find a comparison of the two methods applied to the same company by exhibits 2 and 3. Over a 6-year period, take the same company and let it operate on a dividend basis, take the same company and let it operate the same years on a deviation or advanced dividend basis.

Under this bill as sent to you by the House, you will see from exhibits 2 and 3 that with identically the same premium volume, identically the same losses, identically the same expenses, identically the same net income, the dividend company would have to pay more than $1 million greater tax than the advanced dividend or deviation company.

Now, that just is not right. I do not need to argue or labor that point. That is absolutely unfair, of course. That is a discrimination that is of real magnitude, and the net result of that, if it stays in, will be naturally that management would feel, "well, here, we cannot exercise our judgment as to whether it is better and safer or more desirable for one reason or another to operate on a dividend basis. We will have to go into the deviation basis to avoid this heavy tax penalty."

Now, that discrimination is more important to the smaller and medium type mutuals than it is to the larger ones. The larger type mutual may, perhaps, be better able to stand the impact even of unfair or inequitable taxation.

It would not be right, but they might be better able to stand it. The smaller companies cannot afford to take a chance. If they are going to be saddled with an extra tax because of doing business in the way they think is the best and safest way, then they may be forced to substitute for their best judgment going into taking a chance in order to save taxes.

It should be noted, too, that that is a very bad discrimination against all types of mutuals in favor of the stock companies.

Now, the bill has some special provisions for small mutuals. I have mentioned how it keeps the exemption at $75,000, and it ought to be raised to $150,000. The provision in there whereby mutuals be-

tween $75,000 and $300,000 a year gross receipts could elect to pay on investment income only certainly should be amended so that a company with not exceeding $1 million of gross receipts from every source would have the option of paying on investment income only.

In order to avoid drastic swings in the level of their charges, they must have a means for building up funds for covering the occasional very severe loss years.

Now, stock companies can secure such funds tax free from the equity market. But when a big storm occurs with the mutuals, the mutuals cannot go out to the equity market, they have to get it purely from what they have built up, what they have been able to build up in their surplus.

As to mutuals with gross income between $1 to $5 million, we believe it would be equitable to allow these companies an additional 1 percent of whatever difference there is between their premium volume and $5 million, in addition to the allowance of one-fourth of underwriting gain, if any, plus 1 percent of losses, in their special loss fund.

For instance, take a company—there is a company, Senator Curtis, I do not know whether it is in your hometown or not, but in Nebraska with a total volume of about $3.5 million. In addition to the ordinary loss account that it should be enabled to set aside, I percent of the difference which, in its case would be, say, $15,000. That is not a large amount. The Treasury would not miss it, but it would sure help a company of that size.

Mr. Cate—a fine gentleman. I am very fond of him personally—in his argument he says that this bill, would help the big companies, and he wants to help all companies. Well, I like him, but I do not like his client, and we must "beware of Greeks bearing gifts." When they come in suggesting something that is going to help the mutuals, we say that is like the Russian bear coming over here and saying they want peace.

Now, here is what would happen under the present bill. Three companies in Nebraska in the period between 1951 to 1960, three mutuals, small mutuals, during the most recent 10 years paid $819,000 in Federal taxes. If this bill had been in effect they would have paid $3,813,000.

A company in Utah would have gone from $63,000 tax it paid, would have had to pay $324,000.

An Iowa company had actual taxes of $51,000, would have had to pay about double, $97,000.

A Kansas company that paid $56,000 would have had its taxes quadrupled and paid $238,000.

An Indiana company paying taxes of $274,000 would have had its taxes just about tripled, and paid $820,000.

An Ohio company that paid taxes of $77,000 would have had to pay $494,000, more than six times as much.

Let me say also that is not only true of the farm belt. In New England, and down in my own State of Virginia, the losses of hurricane at one time can just wipe out the savings of years for these smaller companies.

Now, the bill does grant some recognition, recognizes the principle, that a company that has extra hazardous risks, such as tornadoes,

hail, windstorm, earthquake, things like that and has them concentrated, ought to be entitled to a larger loss account. The bill provides that if more than half of its total premium volume of all kinds is in this extra hazardous type of insurance, and if it is concentrated in one State, that then it will get some little extra for the loss account according to the percentage, proportionate percentage, above 50 percent.

That is a good recognition of the principle, but it is utterly inadequate.

Any insurance actuary, I do not care whether he is stock, mutual, or anybody else, dealing impartially, will tell you that a company that has as much as 20 to 25 percent of its premium income in this extra hazardous type of insurance is entitled to very special consideration. When you get up to 50 percent that is just entirely too much.

He will tell you also, when you limit that to one State, that is not a good basis at all. These storms do not recognize the State boundary. When they get up to North Carolina, and then get to the Virginia boundary, they do not say, "We will just stop right here and stick in North Carolina."

They kept on up to Virginia and up to Delaware and on up to New England. With the exhibits attached to this statement is a map taken from the Spectator—that is a very good insurance publication—that shows the pure crop-hail loss ratio to earned premium for all companies in one typical loss year. In 1956, it shows there were 11 States located right together where they had losses running over and above their premium volume, which ran all the way from 60 percent up to 199 percent; 143 percent in Kentucky, 150 percent in South Dakota; 70 percent in Ohio; 199 percent in Iowa. If you take these States and put them together, they are not much larger than the State of Texas, and are not as large as the State of Alaska. So this one State limitation ought to be changed. We think that ought to be amended to say that the concentrated risk mutual is one that has more than 20 percent of its total premium volume in these extrahazardous risks located in contiguous States.

Now, you might put a limit on the number of States, but there again you take States like Rhode Island, Connecticut, Massachusetts, New Hampshire, Vermont, Maine, and you have six States, and all of them could be put in one corner of Texas.

Senator DOUGLAS. Mr. Chairman, may I ask a question?

Do I understand you to say that you regard the State as an inadequate insuring unit?

Mr. WICKER. Well, for regulation purposes, I think it is extremely adequate for regulation purposes; yes, sir. But I think there people are dealing with people; in other words, regulatory commissions are dealing with insurance officials and with rate actuaries. That is people to people.

But when you are dealing with storms—some call them "Acts of God," I say acts of the Devil—you are dealing with acts of the Devil, and storms do not recognize any State boundaries.

Senator DOUGLAS. Might not this be a case for Federal regulation?

Mr. WICKER. Beg pardon, sir?

Senator DOUGLAS. Might not this be a case for Federal regulation, since storms do not respect State boundaries?

Mr. WICKER. No, siree, Bob.

Senator DOUGLAS. I am surprised at you.

Mr. WICKER. Excuse me, I did not mean that brusquely; oh, no.

Senator DOUGLAS. You are contradicting yourself.

Mr. WICKER. Pardon me, Senator, I do not think so. I think we are dealing with different kinds of things.

I think you can say, if you are dealing with apples and bananas, that is one thing. But when you are dealing with apples and hog liver, that is something else. I think——

Senator DOUGLAS. We are dealing with insurance.

Mr. WICKER. Sir?

Senator DOUGLAS. We are dealing with insurance, and only with insurance, so keep the hogs and the apples out. [Laughter.]

Mr. WICKER. Well, that is what we would like to do. We would like to do that. We certainly want to—I won't say that. I was about to say—off the record.

(Discussion off the record.)

Mr. WICKER. I am just about through. I know you have been very patient. I want to tell you, as I say, we are not here pleading for status quo. We could plead for it and with good force and effect, and with good conscience because for 20 years we have been the only segment of taxpayers in the whole United States that have had to pay a tax each and every year regardless of whether they had good years or bad years.

We have paid substantially increasing taxes each year. That has been a stable source of increasing revenue to the Government, and that is recognized as a good thing even by the Allstate people.

In their presentation to the House Ways and Means Committee in 1958 they actually proposed a tax then on all companies just on investment income, and leaving out underwriting. And they said in connection with that, and it is in the printed hearings, that in this manner there would not be extreme fluctuations but there would be a steady rise of revenue predictable within a small margin of error, and that tax would provide a much more stable revenue to the Treasury.

So, I say we can defend if we want to but we are not here defending status quo. We realize that the Government is spending more and more money, whether wisely or unwisely we are not saying, but they have got to have more money. Everybody is demanding more of the Government and costing more and you have got to have more money. So the plan that we worked out, the plan that we presented, the plan that the staff, your staff and the House staff studied for several months and checked all the figures, that plan will produce substantially increased tax revenue and make us pay more taxes.

But it will put the extra heavier tax, the bulk of it on the companies more able to pay and that is where it should be.

It will redistribute the burden properly and it ought to end any of this ruckus about competitive disadvantage or competitive advantage here and there.

We say that we can stand a reasonable tax increase but we don't believe we can stand the punitive tax increase that this bill would put on us. And we certainly don't think that it would be right to tax us on total income and to give us a loss account, a loss fund, a special loss fund, recognizing our need for it, and then take it away almost be-

fore we have had time to look at it and become familiar with it; and to keep taking it away and to take it away arbitrarily at the time we need it the most.

That isn't a fair thing to do, we say, when with other mutual types of insurance, life, and mutual savings and loans and mutual savings banks, the Congress recognizes, even the Treasury recognizes the need for some special tax exempt reserves for losses only. They don't put a ceiling or a force out provision on them, so why in the name of common fairness and equity should they put it on us?

That is our position. As I say our plan would produce substantial increased revenue. In summary and in conclusion, we recommend that this bill be amended, and here is the way we recommend it be amended:

One, eliminate the arbitrary 5-year automatic "forceout" and ceiling from the "Protection Against Loss" account.

Second, eliminate the restrictive provision requiring complete exhaustion of the "Protection Against Loss" account before use of investment income for policyholder dividends.

Now, that is a most amazing thing, gentlemen of the committee. This bill, as passed by the House undertakes on the one hand to tax us on a total income approach, that is, combining underwriting and investment income. They are going to tax us on that. But then they say that if you have a loss, comparing your ordinary premium, and deducting losses and expenses from that, exclusive of returns to policyholders, exclusive of that, if you still have a loss, then you have got to take that current loss and charge that current loss against what you set up in the bill as an emergency loss fund, an excess loss fund instead of charging the loss against total income, and charging your dividends against total income.

Now, they say they allow deductibility of policyholder dividends, but in a loss year wherever policyholder dividends exceed the amount of net premium left over after payment of losses and expenses any refund to policyholders has got to go against the loss account until the loss fund is completely exhausted before you can touch one penny of investment income.

Now, the unfairness of that is twofold: First, as to stock companies, that provision does not exist. A stock company not only can, but does pay policyholder dividends out of investment income.

Why just in the last 10 years 126 stock companies have paid $57 million out of investment income, tax free, in payment of policyholder dividends in loss years. That is perfectly right. They are on total income. We are going to be on a total income basis so we ought to be able to do identically the same thing.

These 126 companies listed in Best's paid policyholder dividends, 1951 to 1960, to their policyholders even in loss years, and the Allstate Insurance Co. was right at the front in that.

The Allstate Co. had an underwriting loss of $1,979,000 in 1956. In that same year, in addition to tremendous stockholder dividends, but they paid tax-free, tax-free, to policyholders $1,619,000 out of investment income, and that was deducted from their income, that was deducted and not taxable, removed from the tax picture.

The very next year when they had an underwriting loss of $1,142,-000 they paid out policyholder dividends tax free out of investment income $1,864,000.

Now, there is nothing wrong with that. That was right, but this bill would not allow a mutual to do identically the same thing.

I say why? There is no reason. The only reason they say, "Oh, well, you don't have a special loss, tax-free loss fund for the stocks." Oh, yes. One-fourth of their surplus has been built up tax free.

So we say this provision requiring us to exhaust, completely exhaust, the loss account before using any investment income for the payment of policyholder dividends is absolutely wrong. It is inequitable and it ought to be absolutely eliminated from the bill.

Third, the $75,000 exemption figure should be increased to $150,000.

Fourth, small mutuals, with a gross income of a million should have the option of taxation on investment income only.

Fifth, loss accounts provisions for medium mutuals ranging between $1 and $5 million certainly ought to be liberalized as I have indicated.

Sixth, special provisions should be more liberal geographically and financially for concentrated risk, extra risk mutuals in extra hazardous lines.

I believe, Mr. Chairman, and gentlemen, that that concludes my covering of my main statement.

As I said I would like to have these exhibits, exhibits attached, put into the record and I wish to thank you very much indeed for your kind consideration in listening to this, to me so long, but the subject is my excuse because this is of tremendous importance, not only to companies, but the millions of policyholders who own these companies.

May I say right there that one member of your committee who unfortunately was detained from being here today asked me, what difference there is between the policyholder surplus of a mutual and policyholder surplus of a stock.

And I said the vast difference is this: That though they have the same names, in the case of a stock company the board of directors can meet any time it wishes and can divert any portion of it and pay it out to third parties.

In a mutual it can only be paid out for losses for pure insurance purposes and never to any third party stockholders. I wont' elaborate on it, but that makes, I think, the vital difference.

Thank you very much.

The CHAIRMAN. Mr. Wicker, I want to say I think you have covered your subject very thoroughly.

Mr. WICKER. Thank you, sir. I hope it's been covered as ably as thoroughly.

The CHAIRMAN. The chairman is very sorry to say that he must leave to meet a very important engagement and I want to ask Senator Douglas if he will kindly act as chairman.

Senator DOUGLAS (presiding). Thank you, Mr. Chairman.

Have you had a chance to look at the statement submitted by Mr. Cate, Mr. Wicker?

Mr. WICKER. No, sir.

Senator DOUGLAS. I wondered if someone would give Mr. Wicker a copy.

Mr. WICKER. I have a copy. Mr. Cate was kind enough to give me one as I came in this morning. He is a mighty nice gentleman as I say.

If his client was as good as he is, he would be all right.

Senator DOUGLAS. Do you have it with you?

Mr. WICKER. I think it is here, sir.

Senator CURTIS. Mr. Wicker was present when the previous witness testified.

Senator DOUGLS. I am going to call his attention to an exhibit.

Would you direct your attention to exhibit B?

Mr. WICKER. Yes, sir.

Senator DOUGLAS. Next to the last page of the exhibits.

Have you found exhibit B?

Mr. WICKER. B for boy?

Senator DOUGLAS. Yes, that is right.

Mr. WICKER. Yes, sir.

Senator DOUGLAS. I assume these figures are accurate.

I would like to ask some questions about it.

For the 10-year period the premiums received by the stock companies amounted to $80 billion. Mutual and reciprocal companies $30 billion.

Now, after meeting expenses and providing for claims the mutuals had an income before taxes of $4 billion, which amounted to 13.3 percent of the underwriting income, whereas the stock companies had an income of, before taxes, of $5,100 million but this was only 6.4 percent of the premiums received.

If one goes to the items above this, you see that so far as investment income is concerned mutuals only earned on investment 3.7 percent on premiums whereas the stock companies earned 5.9 percent, and that the difference is entirely due to the fact that the underwriting income of the mutuals was 9.6 percent, almost $3 billion, whereas the underwriting income of the stocks was a little over $400 million or a half of 1 percent.

I wondered if you would explain to us why the mutuals do so much better on underwriting income than do the stocks?

It is an elemental question, but I think it is important to get into the record.

Mr. WICKER. Well, yes, Senator.

There are a number, of course, explanations offered by different people.

Senator DOUGLAS. Let's get the true one.

Mr. WICKER. Those I have heard—yes, sir.

Those I have heard, in the first place, that mutuals as a group operate more economically in the acquisition of their business.

In other words, they pay less, it costs them less to acquire the business because so much of it is person to person and much of it is directly written, and then, well, frankly, they just don't pay as high expenses.

Senator DOUGLAS. Do you have an approximate estimate, as to the percentage of premiums which the stock companies expend in getting business and the percentage of premiums which the mutuals expend in getting business?

Mr. WICKER. I could get that. I have seen that somewhere. Perhaps Mr. Haskell can supply that. He is executive secretary of our organization.

Our chairman is Mr. John C. Stapel back there. He is the president of the Farmers Mutual Hail Insurance Co. of Columbia, Mo., a little company.

Mr. HASKELL. I call the Senator's attention to one thing, in spite of this larger underwriting that we make we return——

Senator DOUGLAS. I understand. I have another question as to the disposition of the income but at the moment I am trying to find out about the derivatives of the income. The excess is exclusively due to the greater underwriting expense for the stocks?

What I am trying to find out is why your underwriting income is 6.9 percent and the stock companies one-half of 1 percent?

Mr. HASKELL. First, I think we have a lower acquisition cost on the average.

Senator DOUGLAS. Can you give me the average figures on it?

Mr. HASKELL. No, but I can get them for you, I would be very happy to.

Senator DOUGLAS. Can't you make an estimate? This is one of the vital facts of your business.

Mr. HASKELL. It would take a few minutes to look it up. But there is an exact figure on our expense ratio.

Senator DOUGLAS. Do you have a figure for the stock companies?

Mr. HASKELL. There is a figure for the stock companies given also.

Senator DOUGLAS. What would be the approximate cost of acquisition for the mutuals?

Mr. HASKELL. Without looking at the figure I could be so wrong that I would hate to make a guess. I can get the figure for you in a few minutes.

Senator DOUGLAS. Would you not only supply it for the record, but furnish me with a copy?

Mr. HASKELL. Yes, sir.

(Mr. Haskell later submitted the following for the record:)

Percentage of premiums expended for business: Stock companies, 35.9 percent; mutual companies, 25.4 percent. (Source: Best Aggregates and Acreages.)

Senator DOUGLAS. Is this the only economy which you effect?

Mr. HASKELL. No, sir, I think not.

I think it is characteristic of the mutuals, as a class that they are more selective in their risks than are the stock companies as a class, and that this makes a difference, selectivity is an important difference.

Senator DOUGLAS. You mean that throws the burden of insuring the poorer risks upon the stock companies?

Mr. HASKELL. That is somewhat correct, I think.

Mr. WICKER. Except, let me interpolate by saying as to many farm risks there is no market except the mutuals.

In many cases where a farmer has a tough risk and a dangerous risk the only insurance he can get is from the farm mutuals, the only thing he can get. We can't be so selective, if we were always selective there wouldn't be insurance for many of the property owners, particularly in agricultural unprotected areas.

Senator DOUGLAS. I don't want to stir up dissention

Mr. WICKER. No.

Senator DOUGLAS. But your executive secretary says you are more selective and now you say you are less selective.

Mr. WICKER. I think he was referring to some few inconsequential lines. [Laughter.]

I think that is it.

Senator DOUGLAS. Let me ask you this: Do you charge the same premiums?

Mr. WICKER. Sir?

Senator DOUGLAS. Do you charge the same premiums as the stock companies?

Mr. WICKER. In most cases. Well, we are governed the same in the States, stocks and mutuals, whether we are on a dividend basis or deviation basis. On a dividend basis most of the mutuals charge exactly the same premiums as the stocks to begin with, and then return to policyholders the savings at the end of the year.

Senator DOUGLAS. Yes, that is at the bottom of the page.

Mr. WICKER. Yes, sir.

Senator DOUGLAS. What I am trying to get at is this: Is there a loading on the policies of premiums in excess of longtime risks which are credited to underwriting income so far as you are concerned which does not accrue to the stock companies?

Mr. WICKER. No, sir. They get the same loading. When they make up rates, the rates are made up and presented to the state regulatory bodies for approval. In the State of Virginia with which I am more familiar there the rates are presented by the stocks and mutuals.

They present their experience, what their losses have been during the previous years, what the trends are, and then the rates are set the same for both, for all companies.

Now, a company that says it can do business a little cheaper because it has a lower expense ratio, and can prove that, can get approval for what we call a deviated or a reduced immediate rate. But then all the others, whether stock or mutual, charge the same thing.

In fact there are some States where they don't allow deviation, Texas and North Carolina.

Senator DOUGLAS. What you are saying in effect is——

Mr. WICKER. Sir?

Senator DOUGLAS. What you are saying in effect is that your greater percentage of underwriting income is due to your lower percentage cost of operation and administration?

Mr. WICKER. That is correct, acquisition and operation. We don't pay the big salaries. I wish they paid more, as a lawyer.

Senator DOUGLAS. If I may pass to the disposition of the income.

Mr. WICKER. Yes, sir.

Senator DOUGLAS. I now refer to the lower part of Mr. Cate's statement. The figures show you pay 1 percent of your underwriting income, and they pay 1.6 percent. Thus you have the differential advantage over them of six-tenths of 1 percent, is that substantially accurate?

Mr. WICKER. I would say on the average as a whole that would be about right except for this: That completely overlooks the fact that that big percentage, the big percentage which runs pretty close to 9 or 10 percent that we return in refunds to our policyholders, 75 to 80

percent of those go back to business insurance to commercial policyholders.

They may be small fellows, a small plumbing or other business and those people have to pay taxes on it.

Senator DOUGLAS. I understand.

But I am speaking of the——

Mr. WICKER. The company itself.

Senator DOUGLAS. The company itself.

Mr. WICKER. The company itself pays on the average slightly less, the mutual companies slightly less on the average in Federal taxes than the average stock company, but from the premium dollar understand the Federal Government actually gets more out of the mutual dollar than that does out of the stock.

Senator DOUGLAS. So far as the companies are concerned you pay a little, just about 60 percent of the taxes that the stock companies do, is that true, 1 percent as compared to 1.6 percent?

Mr. WICKER. I would say, I would think we pay a little more than that. I haven't had a chance to check these figures, but I will admit, I say that naturally, a profitmaking institution as the stocks are, and it is perfectly proper, they do pay somewhat greater tax.

They pay greater tax just like any profitmaking body pays a greater tax than a nonprofit institution; yes, sir.

Senator DOUGLAS. Now, subtracting the Federal income taxes from the income before Federal taxes, this leaves a net income after taxes of 4.8 percent for the stock companies, and 12.3 percent for the mutuals.

Mr. WICKER. That is right.

Senator DOUGLAS. As I understand it what happens is that stock companies then distribute 3.2 percent of the underwriting income overwhelmingly to stockholders?

Mr. WICKER. Yes, sir.

Senator DOUGLAS. And you distribute 9.2 percent of your underwriting income exclusively to policyholders?

Mr. WICKER. That is correct, sir.

That is correct, sir, and if you will take, I was about to point out, if I had a chance and I am so glad you asked me, on this exhibit B, the correct lineup there would show that the net income retained in the business by the stocks is 4.3 percent, not 4.8, and not 1.6.

If you deduct their refunds to the people who paid it in, the policyholders, from their net income, then you have what they really retain in the business.

When you go and deduct what you pay to third party stockholders, you are doing something that no real insurance actuary will approve of and it is not so.

That is like a man saying his net income is less what he gives to his brother, that is something like that. It is paid to a third party stockholder.

If you put them on the same basis, net income less refunds to those who paid it in, policyholders, you will find that the income retained, according to this exhibit, by the mutuals is around 3.1 percent, whereas the income retained by the stocks will average 4.3 percent.

Senator DOUGLAS. Now, wait a minute.

Mr. WICKER. Yes, sir.

Senator DOUGLAS. The Cate figures show income retained in the business 1.6 percent because the dividends to stockholders have been distributed.

Mr. WICKER. Yes, sure.

Senator DOUGLAS. And, therefore, they show that the actual amount retained in the business, building up surplus and reserve is approximately twice as great proportionately in the case of your companies as in the case of the stock companies.

Mr. WICKER. Well, I say that just isn't so. That isn't so.

Senator DOUGLAS. Why isn't it so?

Mr. WICKER. Well, because it is absolutely illogical, contrary to all insurance principles there to regard a payment to stockholders as something that isn't part of the business.

That payment to stockholders, they have no right to deduct that in determining what their net results are. The net results——

Senator DOUGLAS. Are you saying that there is no distinction between amounts distributed in dividends and capital surplus retained and put into the business?

Mr. WICKER. I think there is but that just illustrates my point that the board of directors at any time can take and divert that surplus and pay it to third party stockholders and that that should not count and does not logically count, in insurance parlance, doesn't count in determining what they really retained.

They retained the thing up there less what they paid their receipts less what they paid out in losses and expenses and refunds to policyholders is what they retained, what they do with it they can at any time declare dividends to stockholders, that is something else.

Senator DOUGLAS. But as a practical matter they distributed approximately 3 percent to stockholders?

Mr. WICKER. That is right.

Senator DOUGLAS. And retained 1.6 percent in the business, and you distributed 9.2 percent to policyholders and as a historical fact retained 3.1 percent in the busines.

Mr. WICKER. Well——

Senator DOUGLAS. I don't see why you are reluctant to admit this?

Mr. WICKER. I am not reluctant, Senator, at all, on that. I am just frankly—I just can't conceive of how a payment to third-party stockholders who have no part in the premiums in there, why can that be regarded as something as part of the cost of doing business? It isn't. That could be——

Senator DOUGLAS. I want to make that clear. I do not regard that as a cost of doing business. We are trying to find out how the net income is distributed.

Mr. WICKER. Well, the net income with the mutuals is distributed only by refunds to their policyholders; save what they keep in there for protection of the policyholders and the public.

In the stocks there is this small amount, a fraction of a percent, that goes to policyholders, the bulk of their net goes to third-party stockholders, and the remainder into a surplus which can be used for two purposes: First, it can be used for losses. The other, it can be used again in distributing more to stockholders, whereas ours can't be used that way.

Senator DOUGLAS. I understand that.

I thought you were going to point with pride to the fact that you had distributed $2¾ billion to policyholders and have built up your surplus in the ratio of 3.1 percent, whereas the stocks have built up their surplus to—I thought you were going to use this as an argument, whereas you seem to shy away from this as though it were some guilty thing.

Mr. WICKER. Well, Senator, let me assure, sir, it is absolutely a matter of pride to us that we have saved, for the insuring public, billions of dollars and returned it to them instead of paying it out to third-party stockholders.

That is a matter of pride; there is no guilt there. We are proud of that fact.

But when you get to this point of what we have built up in surplus, if you will turn, please, sir, to the figures we have here in our statement, you will see that we have actually increased our surplus by only 5.54 percent, while the stock companies have increased their surplus, while this law has been in effect, by nearly 7 percent. That is on page 9 of our statement.

Senator LONG. Mr. Chairman, if I might just interject a point, it occurs to me that the principle reason we are having some difficulty in getting a responsive answer to the question is that the chart to which you are referring here lumps together the mutuals and the reciprocals.

Senator DOUGLAS. I see.

Senator LONG. And the witness is testifying only on behalf of the mutuals.

My guess is that the witness has no experience in the field of reciprocals, so when you show him a chart that lumps somebody else's association to his, he is in position to testify for his own people, but he doesn't really know what the reciprocals problems is.

Senator CURTIS. Will you yield right at that point? It also includes factory mutuals?

Mr. WICKER. That is right.

Senator CURTIS. Factory mutuals and reciprocals?

Mr. WICKER. I thank you very much, Senator, for making that point. I didn't want to, because I don't want to be in position of undertaking to get into explaining something for other types of mutuals just as you have said.

But, in this example here, it isn't comparable to ours.

Senator LONG. It seems to me you would have to separate the mutuals from the reciprocals and you might even have to have a separate column to separate one type of mutual from another type of mutual. It is difficult when you look at something that lumps all competitors against stock companies.

Mr. WICKER. I think you are entirely correct, sir.

Senator LONG. The stock fellows might make a good case when compared with you and several others averaged together, but if they separate your business from those with whom you are averaged in it might not make the same comparison at all.

Mr. WICKER. You are exactly correct, sir, exactly correct; thank you, sir.

Senator DOUGLAS. May I ask one final question: What is the average amount of dollars that you now pay, that the mutuals pay, to the Federal Government in taxes each year?

Mr. WICKER. Well, last year was $41 million, on 1960 it was a little over $41 million. Those were the latest figures which we have and this year I think it is estimated, let's see, 1961, we estimate taxes will run to pretty close to $43,271,000.

Senator DOUGLAS. If the House bill were to become law, what do you estimate your tax payment would be?

Mr. WICKER. Put it this way. We have to project into the future. If the House bill becomes law the tax effect begins as of next January 1; I believe that is correct.

Senator DOUGLAS. For a calendar year.

Mr. WICKER. For a calendar year, next year, we will say it is roughly this: that under existing law, if no change is made in the law at all, would be about $43 million we would have to pay, $43,271,000. Just $43 million just dealing in millions.

Senator DOUGLAS. In——

Mr. WICKER. In our plan?

Senator DOUGLAS. If the House bill were to become law?

Mr. WICKER. All right, sir. If the House bill as it stands were to become law we would pay $81,048,000 to $94,061,000, somewhere between those two, depending upon the vagaries of the way that ceiling, and so forth, would operate.

Senator DOUGLAS. Or $38 million, a minimum of $38 million more?

Mr. WICKER. That is right, sir. At least $38 million more and a maximum of $50,860,000 more.

Senator DOUGLAS. Under your plan, how much more would you pay per year?

Mr. WICKER. About $21 million.

Senator DOUGLAS. $21 million?

Senator LONG. You would split the difference between what the House would do and what the present law is?

Mr. WICKER. Just about, sir.

In other words, we would cut our nails right down to the quick but we wouldn't cut the quick. The House bill would cut the quick, cut the fingers off.

Senator DOUGLAS. I thought you said—I may have misunderstood you.

Mr. WICKER. That was dealing with the last decade.

Senator DOUGLAS. I know; $5 million a year more, $50 million a year—$50 million for the decade.

Mr. WICKER. Now, the question you asked me, I believe I understood you to say——

Senator DOUGLAS. I quote:

> The plan which we presented to the Ways and Means Committee after being thoroughly checked for the figures and calculations would have provided a very substantial immediate increase in mutual tax revenue to the Treasury and taxation of our mutuals, approximately $50 million for the 10 years 1951–60.

According to my division that is $5 million a year.

Mr. WICKER. It is an average of $5 million a year; yes, sir.

Senator DOUGLAS. That is correct. What was the average amount which you paid during that time?

Mr. WICKER. We paid $274,225,000.

Senator DOUGLAS. Or an average of $27 million a year?

Mr. WICKER. That is right, sir.

Senator DOUGLAS. So you, on the basis of the last 10 years of experience, you were proposing an increase of approximately 16 to 18 percent?

Mr. WICKER. That is what it would have been, sir, on the average, if the bill had been in effect in the past decade.

Senator DOUGLAS. But now you are saying——

Mr. WICKER. I understood you to ask me as to what it will be.

Senator DOUGLAS. I understand.

Mr. WICKER. Yes.

Senator DOUGLAS. You are saying next year, however, the increase would be $21 million on a base of $43 million or would be 50 percent?

Mr. WICKER. Forty-five.

Senator DOUGLAS. Twenty-one is roughtly 50 percent.

Mr. WICKER. That is a little too rough, $21,043,000.

Senator DOUGLAS. That is right; that is roughly a 50 percent.

Mr. WICKER. All right.

Senator DOUGLAS. Isn't that right?

Mr. WICKER. Well, I think it is more roughly 45.

Senator DOUGLAS. Oh, no; it would be precisely 50 percent of 42, 21 is one-half of 42.

Mr. WICKER. That is right.

Senator DOUGLAS. So it is almost 50 percent of 43.

Mr. WICKER. That is all right.

Senator DOUGLAS. What I am puzzled about is how, say, you are making an offer which you say next year will increase your burden of taxes by 50 percent when the historical record for the past decade would show that it would only have increased taxes by approximately 16 to 18 percent, that is what I am trying to find out.

Mr. WICKER. All right; I hope I can makei t clear.

Senator DOUGLAS. I would be very happy if you would.

Mr. WICKER. This 16 to 18 percent, Senator, was based on the average, that is like saying we paid $274 million-some in the decade. Dividing that by 10 that is an average of, about 27½ million dollars a year.

Senator DOUGLAS. Correct.

Mr. WICKER. If you will turn to the table, you will see that, how the taxes increased year by year, by year, and instead of $27½ million, for example in 1960 we paid $41,412,000.

So that the average, you see how it increased all the time. The average doesn't count. What we are saying is that we will increase the proposal that we have made, and that we can stand, that we just can stand and no more, no more, would be under our plan, we figure would produce from 40 to 50 percent greater than what we are now paying or would continue to pay if existing law went into effect.

Senator DOUGLAS. Although you also say; if you combine this with the preceding figure, that had your proposal been in effect during the 1950's, it would have increased your tax burden a total of only $50 million, which, in turn, would only have been 18—16 to 18 percent.

Mr. WICKER. But it would have been a great deal more in later years. In the later years would have been greater percentagewise.

Senator DOUGLAS. Why is it greater percentagewise, it would be greater in absolute terms but why is it greater relatively?

Mr. WICKER. Relatively because we had better experience.

The last year was a good year. We had in the decade 1956 and 1957 were terrific loss years, terrific loss year; 1958 was just a break even.

Senator DOUGLAS. Can you assume that in the future you are average—your average is going to be the same as your best?

Mr. WICKER. No, no, sir; and it won't be the same as the worse, either.

Senator DOUGLAS. Then isn't the record of the fifties better than your record for any one year, isn't it a better judge, isn't it a better measurement? Isn't a 10-year average presumably better so far as projection is concerned than a one-year average?

Mr. WICKER. I think so, but if we were projecting 10 years onto the future and say the next decade, therefore, we would have to speculate a great deal, but if we did there we would have to strike an average and the average might be less than this figure that I have given you here, but I am talking now about what would be the effect in the first year.

Senator DOUGLAS. In other words, you are gambling on the fact that next year will be the same as this last year?

Mr. WICKER. We have reason to feel it will be better.

Senator DOUGLAS. What control do you have over hurricanes? What control do you have over fires? What control do you have over catastrophes?

Mr. WICKER. None whatsoever, but if you take a cycle, if you take the cycle of experience through the years, you will find a certain average of loss years and a certain average of good years and they follow along.

We have had some bad hurricanes just along the coast here as you know this year. They have had a mighty bad effect on some companies of all kinds, but perhaps we are too optimistic. Perhaps we are hoping, perhaps there is as much hope to the future, but we are not in here painting any picture of gloom to you, any more than we have to. What we know will happen bad is that if this bill goes into effect as it stands we know that we will be in an awful fix.

Senator DOUGLAS. If you will forgive me for saying it, I think you are attacking the burden of the tax bill with the expected beneficent weather and fire experience which you hope you will encounter, so that you are loading upon, you are blaming the Government for the good fortune which you are going to experience.

Mr. WICKER. I beg your pardon, sir? What we are trying to do is simply to avoid the inequities this bill would put on us.

Senator DOUGLAS. That is all.

Senator CURTIS. Mr. Wicker, I think your table is clearer than your explanation.

Mr. WICKER. I think so. I hope it is anyway. [Laughter.] I sure hope so.

Senator CURTIS. This average that is reflected by this table. In fact you had loss years in 1956 and 1957, that hasn't changed the table.

What's happened is the following: In 1951 this table shows that you paid Federal taxes of $19 million.

There is an increase each and every year including the years that you say were bad years.

Mr. WICKER. Yes, sir.

Senator CURTIS. Up to 1960, and call it inflation, or the people who insured a house at one time for $5,000 raised it to $12,000 or whatever you want to, the question raised about averages as it affects the revenue estimates is quite a side issue, because it is not guessing upon storms or fires or anything else. It is projecting the growth of a business and the value of property which is going to be insured that is going to take more dollars to insure a piece of property in inflation because it is doubled in value.

The reason why the average is lower, in the fifties is lower, because—is because you start out lower and go higher.

I have a question here submitted by Senator Butler of Maryland who could not be here at this time and he would like to have you answer this question.

I understand that under the present law mutual fire and casualty companies must report discount on bonds annually as investment income except for life insurance companies. All other taxpayers including stock fire and casualty companies can treat bond discount as capital gains when the bond is sold or redeemed at maturity.

Does the pending legislation allow capital gains treatment on bond discounts for mutual fire and casualty companies?

Mr. WICKER. No, sir; that is another defect in the pending bill.

It is one which we would hope that your staff along with a number of other technical improvements would be able to make in the bill. That is another inequity in the bill as it stands as I understand it now.

If the House bill stays as it is, and if the Treasury interpretation which we think is very defective and illogical were to stand, we would have to pay in regard to market discount on bonds as ordinary income at 52 percent whereas with others it is regarded as capital gains, with a limit of 25 percent.

Senator CURTIS. In reference to any business, insurance, financial institutions, or the operation of any business, should the tax laws be written to penalize prudent management?

Mr. WICKER. It would seem to me that that would be a perversion of the purpose and proper exercise of tax laws especially the income tax laws.

Senator CURTIS. I mean not intentionally, but it can happen.

Mr. WICKER. Oh, yes, it can happen. If this bill goes into effect the way it is now, it would invade the proper prerogative of a company's board to determine whether it is best to price their product this way or to price it that way. That ought to be a matter which two good companies in the same line may view differently according to their different circumstances and ought not to be influenced by tax legislation, but this bill certainly would.

Senator CURTIS. In other words, gross income in the final analysis under a deviated company or one that pays a policyholder a dividend are the same?

Mr. WICKER. That is right.

Senator CURTIS. And without different tax consequences of different kinds of mutuals they should be allowed the freedom of choice to meet their particular business.

Mr. WICKER. Exactly so.

Senator, there are some very good companies, for example, operating in California. California has some special laws, they are cov-

ered in detail in exhibit 5 in the appendix to my statement here. California has some special laws under which certain kinds of insurance can only be written at what they call bureau rates; 100 percent rate and you can't write certain lines on deviation.

Other lines can. Companies out there write some of their business very properly on a deviated rate and other parts of their business at a full rate, and they exercise their best judgment as to what is the proper thing to do.

Senator CURTIS. Well now, I will try to be brief because we are late.

Mr. WICKER. Yes, sir.

Senator CURTIS. Mr. Cate mentioned how much total insurance other than life was written, $15 billion.

Mr. WICKER. I think it was $15 billion.

Senator CURTIS. $15 billion?

Mr. WICKER. $15 billion.

Senator CURTIS. Gross premiums?

Mr. WICKER. Yes, sir.

Senator CURTIS. How much of those gross premiums are paid to mutuals and how much to stocks?

Mr. WICKER. Well, sir, the latest Best's "Aggregate and Averages," that is a sort of a bible of the insurance industry, shows that for 767 stocks and for 370 mutuals. Now frankly those 370 mutuals do include the factory mutuals so it is somewhat distorted, but that shows premiums of stocks $10,528,841,721.

Senator CURTIS. It is $10 billion?

Mr. WICKER. For stocks, $10.5 billion, and for mutuals, $3.7 billion. But when you take off the policyholder dividends, $10.5 billion for stocks and a little under $3.5 billion for mutuals.

Senator CURTIS. That doesn't include all the mutuals?

Mr. WICKER. Sir?

Senator CURTIS. That doesn't include all the mutuals?

Mr. WICKER. Yes, sir, that does. This figure in Best's does include all taxpaying mutuals.

Senator CURTIS. Well, of the total $15 billion business the stocks do $10 billion and the mutuals do the rest?

Mr. WICKER. I have got a better figure here, if you please. The stocks—yes, you could say $10 billion, and then the mutuals, other than the accident and health and like that, $3.5 billion.

Senator CURTIS. Then the total isn't $15 billion?

Mr. WICKER. Well, yes if you include—I think where Mr. Cate got the $15 billion from is, $15 billion, I think, that includes the accident and health and assessments associations and things like that. I think that must be. I don't know where that figure came from, and maybe the reciprocals. The reciprocals, for instance, did in 1960, 537 million and some, about a half a billion.

Senator CURTIS. In other words——

Mr. WICKER. The fraternals do some and the State funds do some.

Senator CURTIS. Yes. But all nonstock companies do about half as much business as stock companies.

Mr. WICKER. I think it's around, well, in the premium volume, premium volume is one-fourth of the total.

Senator CURTIS. Of course, it depends on, you have got to use the same total as the component parts?

Mr. WICKER. Yes, sir.

I would think nearer, they do pretty close to three times what we do—25, the reciprocals, I think, reciprocals run about 3.2 percent, I think that is a fair figure. The odds and ends in there, and they run the stocks about 70 to 71 percent, the mutuals about 25 percent, the reciprocals about 3.3 percent.

Senator CURTIS. Let me ask you this: You are speaking for fire and casualty and windstorm and what other kind of mutuals?

Mr. WICKER. Yes, sir.

Senator CURTIS. Any other kind?

Mr. WICKER. We are not——

Senator CURTIS. Some automobile mutuals?

Mr. WICKER. Oh, yes, we are speaking for——

Senator CURTIS. But you are not speaking for health and accident and that sort of thing?

Mr. WICKER. Oh, yes, health and accident, the largest health and accident company is a mutual, the Mutual of Omaha.

Senator CURTIS. I understand that. Is it in this bill? It is not in this bill.

Mr. WICKER. To the extent they are treated as a casualty company, yes, sir. To the extent they are treated as a casualty company.

Senator CURTIS. Of the total business written by mutuals, what fraction or what percentage of that is written by mutuals with gross receipts of $5 million or less?

Mr. WICKER. I can give you that, sir.

Approximately 12.5 percent under $5 million. I am talking about tax volume now, not volume—volume of business

Senator CURTIS. I am not talking about tax volume. I am talking about gross premiums.

Mr. WICKER. All right. I have got that here.

Senator CURTIS. Of the companies that have $5 million or less in gross premiums.

Mr. WICKER Yes sir.

Senator CURTIS. What fraction of that is it of the total mutual business?

Mr. WICKER. Do you want that for the decade or do you want it for 1960 alone or do you want it for both?

Senator CURTIS. I just want it for now, because all it is, it is an estimate. It is maybe a tenth or 80 percent or something.

Mr. WICKER. This here, I have it right here. That for those of the 350 mutual companies listed in Best's, Best's Insurance Guide for 1961, the latest issue, 350, in excluding accident and health, multiple, excluding, but excluding factory mutuals and perpetuals out of that 259 have a premium volume as great as $5 million.

Senator CURTIS. Any listed there that would not have a premium of $5 million, they would be listed?

Mr. WICKER. They would be listed.

Senator CURTIS. You say in your opening statement there are 721 mutual fire and casualty companies.

Mr. WICKER. That is right, sir, in our association, we are speaking for.

Senator CURTIS. How many are not in your association?

Mr. WICKER. Well, there are a total of around 2,300, 2,400 companies but of that number around about 80-some percent are these small locals with less than $75,000 gross income.

I would say that we have certainly in our organization, at least 95 percent of mutuals whose income is large enough to be charged with the tax.

Senator CURTIS. Using the measuring stick of gross premium receipts, what percentage of the business is done by companies that have $5 million or less gross premium receipts?

Mr. WICKER. I will give that to you in just a minute, sir.

Approximately 12 percent.

Senator CURTIS. Approximately 12 percent?

That gives me the figure I want.

Now, in your prepared statement there you have six proposals.

Mr. WICKER. Yes, sir.

Senator CURTIS. Which ones of those are of primary concern to the companies that write less than $5 million worth of premium business a year?

Mr. WICKER. Well, of course, No. 3, increasing the $75,000 exemption up to $150,000 is naturally of concern to many of these companies.

Senator CURTIS. That may be of concern to the very, very little ones, that is obvious.

Mr. WICKER. Yes, sir; No. 4 is of concern naturally to every mutual with their gross income under a million, and of the remainder, of the No. 5, and the No. 6 would be of concern, of equal concern to large mutual or small mutual as to concentrated risk. If they have got concentrated risk in extrahazardous form, size doesn't matter; they are equally concerned.

As to the smaller, these under $5 million——

Senator CURTIS. Under $5 million a larger company, over $5 million would have no interest?

Mr. WICKER. No, no one at all.

Senator CURTIS. But——

Mr. WICKER. But as to one and two.

Senator CURTIS. Six is of concern.

Mr. WICKER. Six would be of concern to any company. I don't care what its size is that has this concentration of risk in extrahazardous type.

Senator CURTIS. How about one and two? Are they of equal concern to the small companies?

Mr. WICKER. Yes, sir.

They are of equal concern to the small companies, I liken them to the right and left arm.

Senator CURTIS. In other words, what you are saying is, and I am arbitrarily using the small company, one that doesn't write $5 million worth of business.

Mr. WICKER. Yes, sir.

Senator CURTIS. A company writing less than $5 million is concerned about all six of these problems.

Mr. WICKER. That is correct, sir.

Senator CURTIS. But a company that does over $5 million would have no direct and primary interest in points 3, 4, and 5?

Mr. WICKER. That is correct, sir.

Senator CURTIS. And on that sixth point, your prepared statement——

Mr. WICKER. Yes, sir.

Senator CURTIS. Doesn't suggest a figure that this 50 percent should be changed to but I believe in your oral testimony you said it ought to be 20.

Mr. WICKER. It ought not to be any larger than 20.

Senator CURTIS. And that it should have some geographical bounds other than one State.

Mr. WICKER. I think it is reasonable to have provision in order for it to be concentrated that the risks are being counted in contiguous States but I didn't think it is reasonable to say it should be in one, two or any particular number.

Senator CURTIS. We have some farm insurance companies that do not write automobile insurance.

Mr. WICKER. That is right, yes, sir.

Senator CURTIS. And their whole operation can be affected by one storm.

Mr. WICKER. Yes, sir, that is right.

Senator CURTIS. And, of course, you might have another one that operates in a rather small territory and does automobile business which would not necessarily be affected by storm although it often happens.

Mr. WICKER. Yes, sir.

Senator CURTIS. There was a hailstorm at Holdrege, Nebr., 2 years ago that practically destroyed every automobile in the used car lots. Now in reference to your sixth point and this can be supplied because I want it primarily for the record, and for use of the staff, the Treasury estimates are that the House bill would increase the revenue by $40 million, $41 million, and if your six proposals were adopted you say your revenue would be increased about——

Mr. WICKER. About half of that.

Senator CURTIS. About 24?

Mr. WICKER. Yes, about half of that.

Senator CURTIS. Yes.

Now, I would like to have a breakdown—I do not have to have it at this time, supply it in a day or so, so it will be put into the record—of the difference between $24 million and $41 million, how that would be arrived at as between your six points.

Mr. WICKER. As between the—I didn't get the last part.

Senator CURTIS. The six points that you recommend.

Mr. WICKER. Oh, yes.

Senator CURTIS. In other words, your proposal, you say, would cut the increase in revenue by one-half roughly.

Now, that cut off the House bill, how much of that would be attributed to points 1, 2, 3, 4, 5, and 6, that can be supplied?

Mr. WICKER. Yes, sir.

(The following was later received for the record:)

REVENUE EFFECTS OF ITEMS 1, 2, 3, 4, 5, AND 6 (ON P. 19)

No. 1 and No. 2: In the period of 1951–60, under existing law, the mutuals actually paid $274,225,000 in taxes. Under the mutual plan as outlined in the proposal the mutuals would have paid, had their plan been in effect from 1951 to 1960, $321,876,000, plus an uncertain amount depending upon future use of the

protection-against-loss account. Had the House bill been in effect during this same period, it would have produced a minimum tax of $385,317,000, again, plus an uncertain amount depending upon the future use of the protection-against-loss account.

We estimate that under existing law, for the year 1962 only, the actual tax paid would be $43,271,000. Under the mutual plan, the immediate revenue consequence would have been $64,318,000 in taxes, and under the House bill 10650 the immediate tax impact would have been $81,489,000.

No. 3: These companies paid less than 1 percent of the mutual Federal taxes in 1958, the latest years we have studied by size of company. This change would have eliminated $268,666 of the total $31,245,465 incurred in 1958. We estimate the revenue cost of this provision to be less than 1 percent of the total industry tax under the proposed tax program.

No. 4: Two hundred and fifty-five companies fell into the premium-size grouping between 150,000 and 1 million in our 1958 study. This analysis revealed that these companies would have paid $1,297,472 in Federal taxes if they had been taxed on investment income alone. This would have been $227,888 less than the tax of $1,525,360 actually paid. Again this is less than 1 percent of the total industry tax bill.

We believe most of these smaller companies would elect the option of taxation on investment income only. These small companies would prefer not to maintain the elaborate financial statistics necessary to calculate taxable income on a total income base. Under this assumption, the only revenue loss generated by this option would be the tax on the long-term aggregate underwriting gain, if any.

During the last decade, companies of this size have achieved an underwriting gain of approximately 1.25 percent of earned premium. This gain amounts to $1,250,000, based on the premium volume of $100 million earned in 1958. The tax on this underwriting income would be $650,000 and would represent the probable revenue loss generated by item 4.

No. 5: Our latest study shows that there are 126 mutual fire and casualty companies with premiums between $1 million and $5 million. The aggregate premium volume of these 126 companies was $288 million. The sum of the differences between each of these individual company premiums and $5 million per company totals $342 million for all 126 companies. One percent of this difference is $3,420,000 in additional contribution to the protection against loss account. Of course, this additional contribution is a maximum figure. Many of the individual companies will have underwriting losses and small amounts of taxable investment income and therefore will be unable to fully utilize this additional provision.

If the final tax bill contains any provision automatically forcing out these additional protection against loss contributions, the revenue effect will be nil. Any additional percentage deduction will flow back into the tax stream after 5 years.

If the arbitrary 5-year force-out provision is eliminated, the revenue loss resulting from Item No. 5 would be 52 percent of the $3,420,000 or about $1,750,000 at a maximum. Actually, our studies indicate that only 60 percent of the amount added to the protection against loss account remains there after 5 years even without the force-out provision. The other 40 percent is used to pay losses during the 5-year interim period. Therefore, we estimate a revenue loss of 60 percent of $1,750,000 or about $1 million resulting from provision 5.

No. 6: There are relatively few companies which would qualify as "Concentrated Risk Mutuals," either as defined in the proposed bill or our proposed amendment. The best information we have is that only six companies that would qualify based on the premium requirement are entered in more than one State.

If the final tax bill contains any provision automatically forcing out these additional protection against loss contributions, the ultimate revenue effect will be nil. Any additional percentage deduction will flow back into the tax stream after 5 years.

If the arbitrary 5-year force-out provision is eliminated, the revenue loss resulting from item No. 6 would be 52 percent of an estimated $90,000 or about $47,000.

(The prepared statement and attachments referred to follow:)

STATEMENT OF JOHN J. WICKER, GENERAL COUNSEL, MUTUAL INSURANCE COMMITTEE ON FEDERAL TAXATION

Identification

I am John J. Wicker, Jr., a former State Senator of Virginia, senior partner in the law firm of Wicker, Baker & Goddin in Richmond, Virginia, and General Counsel of the Mutual Insurance Committee on Federal Taxation.

Mutual Committee is Representative of "Regular Mutuals"

This organization (which I shall hereafter call the "Mutual Committee") is composed of 721 mutual fire and casualty companies with more than 27 million policyholders in all States of the Union. While some are business policyholders the great bulk of this number are family policyholders. There are only 45,500,000 families in the United States. Clearly a substantial percentage of all families have one or more mutual policies. The mutuals I represent have been referred to as "regular mutuals" to distinguish them from the Factory Mutuals, and the inter-insurance exchanges generally called Reciprocals, which have somewhat different structures and problems from those represented by the Mutual Committee and are represented by separate spokesmen.

Proposed Legislation (H.R. 10650) is Unfair, Discriminatory and Excessively Burdensome to Mutual Fire and Casualty Companies

I am appearing here today in opposition to certain parts of Section 10 of H. R. 10650. While the bill before you contains principles for the taxation of our companies which we can accept, these principles are so vitiated by limitations and restrictions as to make the provisions of the bill unacceptable, unfairly discriminatory and excessively burdensome. The bill as now constituted does not promote competitive equality between stocks and mutuals but would in fact handicap mutuals in the competitive market.

H.R. 10650 Would Tax Mutuals on Total Income Basis Without Appropriate and Adequate Modifications

In place of the present mutual tax system, H.R. 10650 would tax all our Mutuals except the very small ones (i.e., with less than $75,000 gross receipts) on a modified "total income" basis as follows:

(1) Mutuals with less than $300,000 gross receipts would have a restricted option of taxation of investment income only;

(2) Mutuals whose receipts ranged from $300,000 to $900,000 would have some special deductions allowed which take the form of a declining deduction from underwriting gain;

(3) All Mutuals with total receipts exceeding $900,000 would be taxed on total income (underwriting and taxable investment income combined);

(4) A special "Protection Against Loss Account" (hereinafter called the "Loss Fund") would be set up consisting of 1% of losses plus 25% of underwriting gains, if any. (For certain "concentrated risk" mutuals, the 25% would be very inadequately increased); *However—*

(a) Every year after the first 5 years any amount in the Loss Fund placed therein five years previously except for ½ of any remainder of the amount placed therein on account of the 25% of underwriting gains, would be forced out into current taxable income. This "force out" not only results in the fund being inadequate to serve its purpose as a cushion against excess losses, but would be required regardless of the current financial needs of the mutual, even in a year of tremendous net losses;

(b) The fund is further depleted by the provision that an underwriting loss created or increased by a policyholder dividend must first be deducted from the Loss Fund and this account completely exhausted before using such a dividend as an offset against taxable investment income. This provision is discriminatory as between dividend paying and deviating companies, (discussed in detail later) and further unreasonably depletes and thus makes more ineffectual the Loss Fund.

(c) An arbitrary and unreasonable ceiling is placed on the Loss Fund by providing that no additions may be made thereto whenever the Fund equals 10% of the annual premium volume.

(d) "Concentrated risk mutuals" (i.e. those deriving more than 50% of their premium volume in any one State from insurance against hail, windstorm, tornado, earthquake, etc.), would be allowed to increase the transfer to the Loss Fund in addition to the 25% of underwriting gains by that percentage by which premiums in such hazards exceed 50%. This provision is too

restrictive to cover the feast or famine experience of insurance against these hazards and is too limiting in geographic area.

Specifically, we believe that the proposed bill has a number of very important deficiencies—

1. While recognizing the necessity for a so-called "Protection Against Loss" account, it establishes a five year "force-out" from this account which seriously cripples the very intent which the Ways and Means Committee had in mind and with which we are in accord.

2. The proposed bill discriminates between those mutual companies returning policyholder dividends at the end of each policy year and those who allow an advance dividend or deviation instead.

3. The special provisions for small mutual companies provided in the proposed bill are completely inadequate to maintain a healthy financial condition for their policyholders in our expanding economy.

4. The concentrated risk mutuals should have a more realistic allowance than H.R. 10650 grants.

The Mutual Plan Described

To avoid this discrimination and excessive tax burden our Mutuals would propose that—

1. As a substitute for access to the equity capital market a "Protection Against Loss" account be allowed without restriction, consisting of one percent of incurred losses plus ¼ of underwriting gain, if any.

2. This account be used only in tax loss years, as an offset to the excess of total losses, expenses and dividends over total taxable income.

3. Mutual companies with less than $150,000 gross receipts would be exempt.

4. Small mutual companies (under $1,000,000) be given the option of taxation upon investment income only.

5. The additions to the "Protection Against Loss" account be liberalized for those mutuals with gross receipts between $1,000,000 and $5,000,000.

6. The special provisions for concentrated risk mutuals be expanded realistically.

The Present Law Described

As I have explained in prior statements to the House Ways and Means Committee, Mutual Companies have special characteristics and needs that make it difficult and inequitable to apply a "total income" tax theory to them without substantial modification.

Exactly twenty years ago, a "total income" tax proposal for Mutuals was submitted to you by the House. Recognizing that such a basis of taxation would prevent Mutuals from continuing as a healthy competitive factor in the insurance market, the Senate Committee on Finance, —including men such as Senators George, Walsh, LaFollette, Vandenberg and Taft, and your present Chairman, Senator Byrd,—wisely struck down that proposal.

In its place, your Committee was the primary factor in enacting into the Code the existing law under which Mutuals have been taxed ever since 1942.

Ever since 1942 (under sections 821, 822 and 823 of the Internal Revenue Code), our Mutuals (except the very small companies with annual gross receipts less than $75,000 and which have only 2% of the premium volume of all mutual fire and casualty companies) have been taxed each and every year, regardless of so-called underwriting gains or losses. Their taxes have been based upon whichever of two alternative bases produced the greater tax:

(1) Full corporate rates on their entire taxable investment income (including realized net capital gains), or

(2) One per cent (1%) of their gross receipts, namely taxable investment income and net premiums (i.e. gross premiums less policyholder dividends).

Under the present law Mutual fire and casualty companies have paid very substantial taxes each and every year. Furthermore, the amount of taxes paid has increased steadily every year, reflecting the increase in premium volume that in turn reflects the growth of our economy. The annual amount of Federal income taxes paid by all fire and casualty mutuals listed in "Best's Insurance Aggregates and Averages" has increased, as follows, from less than six million dollars in 1942 to more than forty-one million dollars in 1960:

Year	*Income Tax*
1942	$ 5,629,000
1943	5,682,000
1944	6,263,000
1945	7,642,000
1946	9,213,000
1947	10,262,000
1948	11,624,000
1949	13,250,000
1950	15,514,000
1951	19,759,000
1952	22,980,000
1953	25,378,000
1954	26,107,000
1955	28,297,000
1956	29,940,000
1957	31,771,000
1958	33,742,000
1959	37,380,000
1960	41,412,000
GRAND TOTAL	$381,845,000

The present law has tended to equalize competitive opportunity, but it has not favored the mutuals as a group. For example, during the past twenty years, mutuals have increased their surplus by 5.54% of their premium volume while their stock competitors, as a group, have been able to increase their surplus by 6.76% of their premium volume. (See Exhibit 1.)

Nor has the mutuals' share of the total market unduly increased during the twenty-year period. In 1942, the mutuals I represent wrote 20% of the total premium volume. Today they write 25%. This is a modest growth, but it cannot be attributed to the income tax law. For example, Allstate Insurance Company was taxed as a stock company. Since 1942, its surplus has increased from $3,557,000 to $225,741,000, and its premium volume from $5,494,000 to $495,385,000.

Present Proposal Promoted by Anti-Mutual Agitation of One of the Most Prosperous Competitors

The proposal of the Secretary of the Treasury in his testimony before this Committee on April 2 coincides exactly with the agitation and

propaganda of the so-called "National Committee for Insurance Taxation," which was formed a few years ago as a "front" for the Allstate Insurance Company.

That company is one of the most prosperous of all stock insurance companies. In the course of a comparatively few years it has paid its sole stockholder cash dividends aggregating millions of dollars more than the total stock investment therein. Even in the few occasional years of heavy underwriting losses (1956 and 1957), it paid cash dividends amounting to one hundred per cent (100%) of its total stock par value. During the past four years, government records reveal that it has contributed nearly a third of a million dollars to the anti-mutual lobbying of its so-called "National Committee for Insurance Taxation." Its contributions constituted almost all of this Committee's receipts.

Incidentally, it should be noted that Allstate (as well as other stock companies) pays policyholder dividends. In 1956 it returned $1,619,000 to policyholders although it had an underwriting loss of nearly 2 million dollars. Again in 1957 it paid $864,000 as policyholder dividends although it had an underwriting loss of $1,142,000. This point is noted not to criticize Allstate, but to point out that it is entirely customary to pay policyholder dividends in an underwriting loss year. This same necessity exists for mutuals operating on a participating basis. This is not permitted for the Mutuals under the proposed bill as will be pointed out later. In both of these years, such dividends were deductible from investment income by Allstate under the law applicable to them and directly reduced taxes that might otherwise have been payable on investment income.

Mutuals Need Funds Free of Tax to Make Up for Lack of Access to Equity Capital Market Available to Stock Companies

All insurance companies, both stock and mutual, now maintain for the protection of their policyholders an adequate fund called "Policyholders Surplus." This is what makes insurance possible. It is the cushion which absorbs the inevitable ebbs and flows of losses paid to and on behalf of policyholders. Surplus protection must be increased generally in proportion to increases in insurance provided. Hence, the ability of an insurance company to maintain insurance protection and service its customers in an expanding economy depends upon its capacity to keep its policyholders' surplus abreast of the increased protection it must afford.

During the last ten years stock fire and casualty companies have added $5,278,000,000 to their policyholders surplus funds. About one-fourth of

this represents additional "capital" and "paid-in surplus" contributed by stockholders tax free. This tax-free addition to surplus is just over one percent of the earned premiums written during the same period. This access to the equity capital market is a source of tax-free surplus funds not available to mutual fire and casualty companies and if the mutuals are to maintain a sound financial condition in meeting the expanding needs of the economy, they need some substitute for this lack of access to the equity capital market.

In the past, untaxed underwriting income of the mutual fire and casualty companies has supplied approximately 1 percent of earned premiums to add to surplus funds, and this has enabled the mutuals to keep pace with the stock companies' additions to surplus from the equity capital market. The pending bill would radically change this by applying a "total income" tax approach to all funds received by mutual companies and the "Protection Against Loss" account provided by the bill would actually furnish only a very small fraction of the needed funds without tax liability. This has been demonstrated by actual records to be necessary for both stock and mutual companies. As a matter of fact, the plan recommended by the mutual companies would have placed in the "Protection Against Loss" account only 0.7% of premiums for the 1951-1960 period.

The impossible situation in which this places the mutuals can easily be demonstrated by visualizing the problem of a mutual company wishing to acquire funds from policyholders to improve its financial condition, to increase its present surplus, or to comply with license requirements. The need for such periodic additions to surplus occurs among all companies, large or small, stock or mutual. For example, within the last four years, two of the largest stock companies (one of them Allstate) have each added $50,000,000 to surplus funds from the equity capital market to strengthen their financial statement. For a mutual company to add the same $50,000,000 to surplus funds under the House bill would require a policyholder contribution of premiums of nearly $92,000,000 over all loss and expense requirements. It is difficult to recall one provision of tax law which treats members of the same industry in such inequitable fashion.

Some states have laws which allow a mutual company to meet surplus requirements on a tax-free basis through securing paid-in guaranty funds, which are merely borrowed funds rather than equity capital. These funds are subordinated in all respects to all other claims against the company. Further, since these funds are in no sense equity capital, only the amounts loaned may be repaid, they are callable at the option of the company,

and interest payable is limited by statute. Such loans can only be obtained in very special situations.

The mere fact that all of the Mutual Fire and Casualty Companies combined only had $16,359,000 of such money paid in during the last 10 years (less than 7 cents per $100 of premium written) is evidence that this is not a practical solution to the problem of providing a substitute for access to the equity capital market.

With the 5-year "force-out" provision for almost all of the "Protection Against Loss" account, the maximum benefit to a mutual company is the privilege of holding this money five years. After taxes, the net benefit of this for policyholder protection in the form of surplus would be only in the range of 5¢ or 6¢ per $100 of premium writings. The benefits of that part of the "Protection Against Loss" account not forced out is similarly minimal, averaging less than 10¢ per $100 of premium.

Protection Against Loss Account Not Excessive

It has been claimed, and there is some remote possibility, that without some overall size limit, the account might become excessive for a few individual companies. Our study of the 20 largest companies indicates this is unlikely, and as previously noted, the average size of the account, without limitation, was only 5% of premium over a 10-year period. Further, in the case of mutual savings institutions this same problem has been placed in the "continuing review" category by the Ways and Means Committee and the report states:

> Your committee's bill does not impose any overall ceiling on the amount which may be accumulated by a mutual savings institution with respect to its reserve for losses on qualifying real property loans. However, your committee intends from time to time to review the status of this reserve to be sure that the balances maintained in these reserves remain reasonable in light of the overall requirements of the mutual savings institutions.

Similar treatment is required for our industry.

Principle of Full Retention Well Established

The principle of providing a protective account which could be retained by a mutual form of organization for the protection of its participating owners, without any time or amount restriction, has been established in the 1959 Life Insurance Income Tax Act and reaffirmed in the present H.R. 10650 as it applies to Mutual Savings Institutions.

In the case of a Life Insurance Company, either stock or mutual, 50% of Underwriting Gain in a given year is placed in a special account.

In a Mutual Life Insurance Company this special account is never taxed or limited. In a Stock Life Insurance Company, the size of this special account is limited, after which 100% of the underwriting gain becomes taxable. Thus, the law completely recognizes the distinction between stock and mutual companies.

In the case of a Mutual Savings Institution, the proposed bill provides for the establishment of a reserve equal to 60% of taxable income for the year. This special reserve account is neither limited as to overall size, nor automatically forced back into the tax stream after a given length of time.

Just as the long-term protection of the participating owners and the peculiar nature of the risks of such institutions warrant no restrictions as to size or time on special reserve accounts for Mutual Life Insurance Industry and Mutual Savings Institutions, the special circumstances of the Mutual Fire and Casualty Industry warrant similar treatment.

"Protection Against Loss" Account in H.R. 10650 Inadequate

A review of the record of the entire mutual fire and casualty insurance industry for the last 20 years indicates that with the 5-year "force-out" provision the "Protection Against Loss" account would seldom be adequate to cover periods of heavy losses. In 1956 and 1957 the industry suffered consecutive years of substantial underwriting deficits, and the following year, 1958, was just at a break-even point.

These three disastrous years in a row clearly shows the jeopardy to which all mutual fire and casualty companies would be subjected under the proposed bill. If additions prior to the five-year limits had not been allowed to accumulate without limit or force-out, the protection against loss funds developed by moderate addition over a 5-year period would be quickly dissipated just at the time when they would be most necessary for the purpose for which the fund was designed.

As a matter of record, within the last 10 years, two of the 20 largest companies went through consecutive 3-year periods where their total operating deficits (all outgoing items over all incoming items, including taxable investment income) were in excess of 10% of one year's earned premium.

If this can happen among the larger companies, the possibilities are obvious that successive-year deficits of smaller and less diversified mutual companies can run substantially higher than the suggested overall limit of the "Protection Against Loss" account.

Removing Time and Size Restriction Does Not Change Concept of Tax on Total Income

It should be made clear that in requesting that the "Protection Against Loss" account be allowed to accumulate without restriction as to either time or size, the Mutual Fire and Casualty industry is not seeking to change the concept that taxes are payable on a "total income" basis. All of the funds retained in the "Protection Against Loss" account are subject to use as an offset to extraordinary losses, and there is no way under the proposed bill for mutual companies to transfer funds out of the account, except as an offset to losses. Rather, we are asking that the special account be allowed to grow to a size sufficient to serve its intended purpose, as has been well stated in the Ways and Means report on H.R. 10650 (H. Rept. No. 1447, 87th Cong., 2d Sess., pp. 42-43):

> This accumulated underwriting income constitutes its reserve out of which insurance losses can be paid, and the existence of such reserves is an important protection to the mutual policyholders.
>
> Eventually, these companies will pay tax on their total income, but the tax deferral formula of the bill gives recognition to the mutuals' lack of access to the capital market for funds with which to pay losses.

This recognizes that the Mutuals have a special need.

However, even if the concept of taxes payable on total income is accepted, the special provisions in the proposed bill fail to achieve the aim of providing a substitute for the Mutuals' lack of access to the equity capital market. The "Protection Against Loss" account is so restricted in size, by the force-out provision, and by the order of its use, that it cannot serve its intended purpose.

H.R. 10650 Discriminates Unfairly Against Mutuals Returning Policyholder Dividends at the End of the Year

H.R. 10650 contains a provision which provides that whenever a policyholder dividend creates an underwriting loss, such portion of this loss as is attributable to the refund to the policyholders shall first be deducted against any funds in the "Protection Against Loss" account before being used to offset taxable investment income.

This provision is grossly discriminatory. It penalizes companies which choose to write participating policies.

A company which wishes to use an $85 price for a unit of coverage may either charge $100 and return $15 as a participating "dividend" at the end of the policy period, or it may elect to charge $85 and grant

no participating dividend. Both stock companies and mutual companies may use either method, though the participating method is more common for mutual than for stock companies.

The choice of using the participating or nonparticipating method is properly within management discretion. It should not be influenced by tax provisions encouraging one method or the other. But once the choice of desired net premium charges is made on either method of operation, management has little control of the amount of losses which will be incurred in given years. For any individual company in either method, there will be good years and bad years. Both try to retain some portion of the "underwriting gain" in good years to offset the "underwriting loss" of the bad years. The "Protection Against Loss" provision in H.R. 10650 recognizes this principle, but then nullifies its effectiveness.

Though the net price may be comparable on a participating or nonparticipating basis, sec. 824(d)(1)(A) in Section 10 of the House Bill produces the amazing result of greatly reducing the effect of the "Protection Against Loss" account provisions for participating companies compared to the treatment of nonparticipating companies.

The Financial Magnitude of Discrimination Is Material for a Large Number of Mutual Companies

There are two exhibits (Exhibits 2 and 3) appended in which the operation of the "Protection Against Loss" account is shown for two companies —first, one that operated on a dividend basis and, second, one that operated on a deviated basis. (A deviated basis is the establishment of a rate in which the company anticipates the savings to policyholders by paying such anticipated savings in advance instead of paying a dividend.) For both exhibits, the company has been delivering the identical insurance protection to similar customers for the same net prices.

If a company were to operate on a dividend basis, as shown on the first exhibit, the "Protection Against Loss" account would never amount to more than $730,000 which is less than 3% of a typical year's losses. However, if the company were to operate on a deviated basis, the "Protection Against Loss" account would slowly rise to a little over $2,000,000 in the six-year period shown.

In those six years, the dividend-paying company would have paid over $1,000,000 more in Federal taxes than the deviating company.

We see absolutely no valid reason for this provision, and the committee report throws no light as to why it was adopted.

We can suspect that there was a feeling that it is improper for a participating company to refund sufficient premiums so as to create an underwriting loss in any given year. If this be a true surmise, it totally ignores the realities of the business considerations entering into choosing the participating rate.

Dividends to policyholders have always been deductible under the stock company base. Indeed, the record shows that in particular years stock companies have paid dividends that have created or increased underwriting losses and that these losses have been considered properly chargeable to otherwise taxable investment income. This is true even of the Allstate Insurance Company as previously pointed out. (See Exhibit 4.)

In the past, the tax law did not materially influence dividend practices. Nevertheless, both participating stock and mutual companies have shown an almost universal "level dividend" history. That is, while there may have been gradual changes in the participating margin, over a long period of years, there is a very little up and down movement in dividend rates, depending on the underwriting results of a particular year.

The public does not want widely fluctuating net insurance costs from year to year. For example, people simply do not want to pay a very low premium for windstorm coverage in years in which there are no property destroying hurricanes and then extremely high premiums in years when there are two or three.

Both participating and nonparticipating companies properly respond to such public demand. For the nonparticipating company, this means there will be years of underwriting gain and other years of loss. It means the same thing for the participating company.

The provision under discussion has no effect on the nonparticipating company. To avoid the tax loss described above, the participating company would have to adopt a variable dividend rate. In good years, it could pay perhaps a 25 or 30% dividend without creating an underwriting loss. But in bad years, it would have to skip or drastically reduce dividend rates to avoid tax penalty. The result would be to impair its competitive position by wide fluctuation in the net price from year to year after dividends.

Further, it should be noted that a company may elect to write some of its lines of business on a participating basis and other lines on a nonparticipating basis. Such a company could have an underwriting loss created wholly by its nonparticipating business. Yet this provision would

penalize the company because it paid dividends on its profitable participating business.

In summary, the provision under discussion would interfere with proper management decisions. To avoid tax penalty, it would tend to force companies to choose one of two widely accepted pricing methods—the nonparticipating over the participating method. Alternately, it would tend to force companies which remained on the participating basis to adopt a varying rate of return premium dependent on fortuitous and temporary swings in the loss cycle. The discriminatory tax effects of the provision could be avoided by either choice without increasing revenue. It is submitted the existing provision should be removed as an artificial interference with the choice of accepted alternative practices of pricing insurance on a participating or nonparticipating basis.

For a fuller explanation of this subject, see Exhibit 5.

H.R. 10650 Provisions for Small Mutuals Are Not Adequate

The proposed bill continues the present exemption of the very small companies with less than $75,000 of gross income, a carryover from the 1942 law. Such very small companies are generally little more than loose agreements by small groups in rural areas to share losses, tending to develop little or no true taxable income. Since 1942, values of properties have increased and simply to maintain the scope of the 1942 exemption of $75,000, a $150,000 exemption is currently necessary.

For slightly larger companies with gross income between $75,000 and $300,000 the proposed bill permits them to elect to pay on investment income only. Recognizing that the underwriting results of small Mutual Companies are inherently unstable, we believe that a much higher limit of $1,000,000 should be placed on this provision. Much of what appears in the statement of such companies as "underwriting gain" in a given year simply represents below-average loss experience for that year and well may be offset by higher-than-average loss experience in other years.

For such companies to avoid drastic swings in the level of their charges, they must have a means for building up funds for covering the occasional very severe loss years. A stock company starting out can secure such funds tax-free from the equity market, but this source of capital is not available to mutuals and underwriting income provides the only practical source for Mutual Companies in this size range.

The proposed House Bill presently provides that those companies between $300,000 and $900,000 of gross income are to be taxed on underwriting gains but with a special deduction of one percent of the difference

between $900,000 and actual gross income. A special deduction disappears at the $900,000 level of gross income. The limits for this rule should be raised to cover the $1,000,000 to $5,000,000 gross income bracket. As a substitute for the Ways and Means one percent rule, and in keeping with the need of these companies, it is suggested that the permitted additions from underwriting gain to the "Protection Against Loss" Fund for these small mutuals be measured by one percent of the difference between the company's gross income and $5,000,000. This will develop a smooth transition from an investment income tax at the $1,000,000 level to the use of the regular mutual tax provisions at the $5,000,000 level of gross income.

It should be emphasized that the fluctuations in loss ratio encountered by the smaller Mutual Companies make it essential that they retain a much larger share of their underwriting income during the good years in order to have it available for the protection of their policyholders in bad years. The effect of the present bill in forcing away such reserves in good times can be illustrated by the following examples:

Three companies in Nebraska paid Federal income taxes during the most recent ten years of $819,000. Under H.R. 10650, during the same period, the Federal income taxes of these companies would have totaled $3,813,000.

A company in Utah paid Federal income taxes aggregating $63,000 during the last ten years, and under the proposed bill, its tax burden would have been $324,000.

An Iowa company had actual taxes of $51,000 and would have paid taxes of $97,000.

A Kansas company paid taxes of $56,000 and would have had taxes under the proposed bill of $238,000.

An Indiana company paid taxes of $274,000 and would have incurred taxes of $820,000.

An Ohio company paid taxes of $77,000 and would have paid taxes of $494,000.

These examples illustrate the injustice of this bill in taxing away the funds of these relatively small companies in good years and limiting the availability of these funds in the underwriting loss years. Carry forward and carryback rules give only partial relief and in no event allow such

companies to show adequate statement surplus or to qualify under the rules of various mortgage lending institutions.

Concentrated Risk Mutuals Should Have Less Restricted Allowances Than H.R. 10650 Grants

H.R. 10650 recognizes that concentrated risk companies have a special need regardless of premium size, but the restrictive definitions are so narrow as to render the provisions largely inoperative in achieving the intended objective.

Such extra hazardous loss insurance on property is almost always written in connection with the ordinary property coverages, and only a few companies are likely to have more than 50 percent of their premium from the extra-hazardous risk coverage alone. However, there are a number of companies which do specialize in risks of this type and as a result do not have diversification of coverage as a cushion against these extra-hazardous losses. For them, as well as the more general writing mutuals, the 50% of premium limitation in extra-hazardous lines is too restrictive.

Similarly, the bill imposes a one-state geographical limit. This still leaves the problem of slightly larger companies which still serve contiguous geographical areas, and, as we all know, storm areas do not recognize state boundaries. Recognizing that some geographical limit might be desirable, it is suggested that a concentrated territory be defined as a "contiguous area located in four states or less."

Our "Mutual Plan" Would Provide Substantially Increased Tax Revenue, But Not an Unbearable Tax Burden

Under the "Mutual Plan" which we urged unsuccessfully on the Ways and Means Committee, the Federal income taxes that would have been immediately incurred by our mutuals during the ten years 1951-1960 would have aggregated approximately $322,000,000 ($321,876,000). In addition, there would have been a further tax liability of uncertain amount, as the remainder in the "Protection Against Loss" account was used as an offset against future tax losses. This would have been a substantial increase above the $274,225,000 actually incurred which the mutuals would have found to be burdensome, but nevertheless bearable because of the existence in the plan of the special "Protection Against Loss" account.

H.R. 10650 with its arbitrary maximum limit, its 5-year "force-out" provision, and its requirement that the "Protection Against Loss" account

be used for dividend-created underwriting losses (before offsetting any investment income) would have saddled our mutuals with an aggregate tax ranging from a minimum of $385,317,000 up to a maximum of $403,857,000, thereby wiping out most of the "Protection Against Loss" account.

Mutuals Can Stand Reasonable Tax Increase but H.R. 10650 Is Unreasonable

Mutual insurance, like any other highly competitive business, can bear reasonable increases in taxation. However, the proposed H.R. 10650 could result in unjust and intolerable injury to the protective strength supplied by these companies in the interest of the policyholders, claimants, and the general public.

In determination of any tax plan, it should be recognized that all mutuals at one time or another sustain exceedingly heavy underwriting losses. In the case of ordinary loss, the impact can usually be met and overcome by the use of taxable investment income and this is the way it should be under any so-called "total income" approach. Unless the "Protection Against Loss" account is allowed to build up and remain available for "excess losses" (i.e., exceeding investment and underwriting income) without arbitrary force-outs, it will not be available for accomplishing its really essential purpose, to provide help in the event of unusual or catastrophic losses.

Our Mutual Plan Would Produce Substantially Increased Revenue

The plan which we presented to the Ways and Means Committee—after it had been thoroughly checked and its figures and calculations verified by the staff of the Joint Committee on Internal Revenue—would have provided a very substantial immediate increase in mutual tax revenue to the Treasury and in taxation of our mutuals—approximately $50,000,000 for the 10 years 1951-1960. We submit that this is as heavy a tax increase as should reasonably be forced upon any large segment of taxpayers, especially when that segment is composed of non-profit companies with no third-party stockholders and with no possibility of the funds being used for anything other than insurance purposes.

Of course, we realize fully the desire of the Treasury for more and more revenue. We realize that this tax bill in some parts provides for a very substantial reduction in tax revenue by way of investment credits, etc.; and we know that the Treasury is anxious to gather in as much

money as possible from taxation of various sources. Nevertheless, we submit that the need of the Treasury for more revenue and its desire to balance tax reductions in some lines by tax increases in other lines cannot fairly or logically be argued as any proper reason for unloading an unconscionably large increase upon some one segment of our economy—especially when that is a non-profit segment and is one upon which 27 million of our people depend for essential insurance protection.

Summary and Conclusion

In summary and conclusion, we urge that H.R. 10650 be amended as follows:

(1) Eliminate the arbitrary five-year automatic "force-out" and ceiling from the "Protection Against Loss" account;

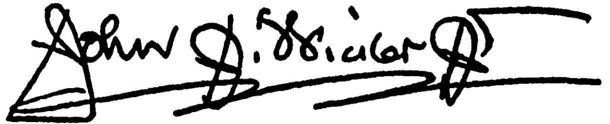
(2) Eliminate the restrictive provision requiring complete exhaustion of the "Protection Against Loss" account before use of investment income for policyholder dividends;

(3) Increase the existing $75,000 exemption figure for very small mutuals to a more realistic figure such as $150,000;

(4) Permit small mutuals (i.e., with gross income under $1,000,000) the option of taxation upon investment income only.

(5) Liberalize the additions to the "Protection Against Loss" account of medium mutuals (i.e., with gross receipts ranging between one and five million dollars).

(6) Make adequate the special provisions for concentrated hazardous risk mutuals.



APPENDIX

Exhibit 1

FIRE AND CASUALTY INSURANCE COMPANIES

1942-1960 (inclusive)

	Stock Companies	*Mutual Companies*
1. Net Premiums Written	$110,305,054,000	$36,451,523,000
2. Less Policyholder Dividends	623,776,000	3,598,353,000
3. Net Premium Income	$109,681,278,000	$32,853,170,000
4. Additions to Policyholders Surplus	7,330,609,000	1,766,315,000
5. Percentage of Net Premium Income added to surplus (4 ÷ 3)	6.72%	5.38%

Exhibit 2

SIX-YEAR EXPERIENCE—DIVIDEND MUTUAL

(000's OMITTED)

	1st Year	*2nd Year*	*3rd Year*	*4th Year*	*5th Year*	*6th Year*	*6-Year TOTAL*
Taxable Investment Income	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 12,000
Premiums	50,000	50,000	50,000	50,000	50,000	50,000	300,000
Dividends	7,500	7,500	7,500	7,500	7,500	7,500	45,000
Net Premiums	42,500	42,500	42,500	42,500	42,500	42,500	255,000
Expenses	17,500	17,500	17,500	17,500	17,500	17,500	105,000
Losses	23,000	27,000	23,000	27,000	23,000	27,000	150,000
Operating Outgo	40,500	44,500	40,500	44,500	40,500	44,500	255,000
Indicated Underwriting Gain	2,000	—2,000	2,000	—2,000	2,000	—2,000	0
Additions to Loss Fund:							
1% of Incurred Losses	230	270	230	270	230	270	1,500
25% of Underwriting Gain	500	0	500	0	500	0	1,500
Subtractions from Loss Fund	0	1,000	0	1,000	0	1,000	3,000
Loss Fund at Beginning of Year	0	730	0	730	0	730	0
Loss Fund at End of Year	730	0	730	0	730	0	0
Taxable Income	3,270	730	3,270	730	3,270	730	12,000
Tax at 52%	1,700	380	1,700	380	1,700	380	6,240

Exhibit 3

SIX-YEAR EXPERIENCE—DEVIATION MUTUAL

(000'S OMITTED)

	1st Year	*2nd Year*	*3rd Year*	*4th Year*	*5th Year*	*6th Year*	*6-Year TOTAL*
Taxable Investment Income	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 2,000	$ 12,000
Premiums	42,500	42,500	42,500	42,500	42,500	42,500	255,000
Dividends	0	0	0	0	0	0	0
Net Premiums	42,500	42,500	42,500	42,500	42,500	42,500	255,000
Expenses	17,500	17,500	17,500	17,500	17,500	17,500	105,000
Losses	23,000	27,000	23,000	27,000	23,000	27,000	150,000
Operating Outgo	40,500	44,500	40,500	44,500	40,500	44,500	255,000
Indicated Underwriting Gain	2,000	—2,000	2,000	—2,000	2,000	—2,000	0
Additions to Loss Fund:							
1% of Incurred Losses	230	270	230	270	230	270	1,500
25% of Underwriting Gain	500	0	500	0	500	0	1,500
Subtractions from Loss Fund	0	270	0	270	0	270	810
Loss Fund at Beginning of Year	0	730	730	1,460	1,460	2,190	0
Loss Fund at End of Year	730	730	1,460	1,460	2,190	2,190	2,190
Taxable Income	3,270	0	3,270	0	3,270	0	9,810
Tax at 52%	1,700	0	1,700	0	1,700	0	5,100

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Exhibit 4

ALL STOCK COMPANIES
(Listed in Best's Insurance Guide)

AMOUNT OF INVESTMENT INCOME USED TAX FREE TO PAY POLICYHOLDERS DIVIDENDS

Year	Amount
1951	$ 6,842,000
1952	4,396,000
1953	659,000
1954	1,003,000
1955	1,318,000
1956	9,753,000
1957	11,699,000
1958	7,869,000
1959	8,052,000
1959	8,052,000
1960	6,357,000
	$57,948,000

Exhibit 5

H.R. 10650 Discriminates Unfairly Against Mutual Companies That Return Savings to Their Policyholders in the Form of Dividends at the End of the Policy Year. This Discrimination Should Be Eliminated.

The "Protection Against Loss" account (hereinafter called P.A.L.) is intended to give recognition to the mutuals' lack of access to the capital market. However, the operation of the account is such that it provides less benefit for mutual companies that customarily return unused or unabsorbed premiums in the form of policyholders' dividends than it does for the companies that customarily anticipate premium savings in lower initial rates. This disparity can be substantial for two companies that may have identical operating results and may provide insurance at identical net premiums to their policyholders.

This disparity is not justified by any of the differences between the participating and the deviating method of operation. Policyholder dividends are an ingredient of the net price that a policyholder pays an insurance company for some insurance protection. In their effect on revenue from customers, they are indistinguishable from premium returns under retrospectively rated policies, premium adjustments made after exposure audits, or any other item in which a previous charge to the policyholder's account is reduced. There are contractual differences, but these differences in no way correspond with any concept of tax equity. There are some practical differences, but these do not correspond with any difference in need for the P.A.L. account.

In preparing a brief, it is commonly more difficult, or at least more time consuming, to prove the absence of any reason for something than either to demonstrate a valid reason where one exists or to refute an invalid one where such a one has been specified. The Report does not reveal why this discrimination was inserted. We do not know why. Thus we find ourselves obliged to cover more ground than might be necessary for the refutation of some theory if a theory had been revealed to us.

Our point is that neither the Treasury nor the public have anything to gain by making the deviating method of operation more attractive than the participating method of operation. To lay a foundation for this point we will describe in general terms the participating method of operation and list its advantages, disadvantages and limitations. Several inferences will emerge from this discussion:

1. The participating method is not a substitute for access to the capital market.

2. To treat its policyholders fairly, a mutual company may feel obliged to pay substantially the same rate of dividend over a long period of time. Such dividends may contribute to an underwriting loss in a year of adversity. This kind of an underwriting loss has the same tax significance as an underwriting loss sustained by a deviating company.

3. A large part of investment income is made possible by the fact that policyholders pay in premiums before mutual insurance companies pay out losses on their behalf. The use of investment income to reduce the cost of insurance protection is obvious, proper and should be of equal tax consequence whether accomplished through dividends or deviated rates.

Finally, we will exhibit an example of the discrimination we find troublesome. It is of more financial consequence to some kinds of dividend paying companies than to others. But all mutual companies financially affected or not, participating or deviating, have a direct concern in any precedent for tax discrimination against the participating method of operation.

The discussion follows in outline form:

1. *Policyholders' dividends are a part of the net price that policyholders pay for insurance protection.*

The cost of insurance must be divided in an equitable way among those who contribute premiums. There are two approaches to this necessity: that followed in participating insurance and that followed in nonparticipating insurance.

Under nonparticipating insurance the entire pricing discretion of the underwriter is exercised in advance. Both the buyer and the seller know the exact formula under which the price of insurance will be determined, and in most instances know in advance the exact number of dollars.

Under participating insurance the pricing discretion is exercised in two steps: an initial determination of the policy premiums or premium rates and a subsequent determination of the portion of premium income that may be returned in policyholders' dividends. The obvious appeal of the two-step approach is that the underwriter knows more about the risks he insured after the fact (or after some of the facts) than he does before.

It must not be thought that the second step is deferred until the underwriter's knowledge is complete and that the hindsight eliminates exposure to risk. It is sufficient to say that the underwriter knows more about his commitments at the time he is recommending policyholder dividends than he did when he established the initial premium. This increment of knowledge may be limited to an awareness that no adverse trends of unexpected magnitude have developed from which he infers that it will not be imprudent to continue a going dividend rate.

It is probably unfortunate that mutuals traditionally use the word "dividend" when referring to the return of unused premiums in two-step pricing. To many people, the word "dividends" connotes a return to investors on equity capital. Our so-called "dividends" have no connection whatsoever with the dividends received by a stockholder as his share of what the corporation has earned on the

capital he invested in it. The returns (dividends) that a mutual company uses to adjust its prices depend primarily on the amount by which the company and its policyholders are willing to have initial rates increased in order to give greater scope to the second step. For example: If a company's method of doing business permits it to pay losses and expenses with a $.90 premium rate, it may charge a $1.00 rate and expect to pay a 10% dividend; or it may charge a $1.20 rate and expect to pay a 25% dividend. So conceivably it might charge a rate of $1.80 and expect to pay a 50% dividend. There are practical boundaries to this range of discretion, but it must be obvious that these returns are price adjustments with customers, that they are received by policyholders in their capacity as customers, and that they have no similarity to the dividend an owner (stockholder) receives when the corporation he owns distributes a profit it made by selling hairbrushes to some outside customers. We would be well served to have another word for the second step in two-step insurance pricing, but the tradition is too deeply entrenched for a change to be made now.

2. *Insurance written on the participating basis has a well established place in the insurance market.*

We do not believe there are any authoritative compilations which show how much premium is written subject to subsequent adjustment by policyholders' dividends and how much is written in such a way that the final cost is determined by rates and rating plans that are a part of the policy contract. Such things can be estimated only by looking at dividend totals and premium totals in compilations such as Best's and working with assumptions as to what average dividend rates may be. But it is possible to make some general statements that are thought to be noncontroversial.

A. While participating insurance does not dominate the market as it does in the life insurance field, it is a substantial minority element in the fire and casualty field. Participating insurance (in both stock and mutual companies) is estimated to involve between 15% to 20% of the fire and casualty premiums. It is estimated to involve more than 65% of life insurance premiums.

B. Within the fire and casualty field, participation is used more extensively in commercial insurance than in personal insurance. As much as 40% of workmen's compensation insurance is written subject to participation. Probably less than 7% of private passenger automobile business is written subject to participation.

C. Stock companies as well as mutual companies write participating policies. Of the eight largest stock fleets, all pay some policyholders' dividends. Stock companies pay about $5,000,000 in California workmen's compensation dividends annually. A very large stock company specializing in automobile insurance pays over $2,000,000 a year in policyholders' dividends to adjust its requirements to certain state laws.

3. *Participating insurance has a well established place because it has some sound utility.*

Much of the utility stems from the fact that the underwriter has more information to work with when he completes his pricing than he would have on a nonparticipating basis. But there are other specific uses.

A. *To provide a security margin.*

Because the underwriter can, in the event of an emergency, increase his net prices by withholding dividends that might otherwise have been contemplated, his company has an element of security that a nonparticipating company does not have. Because it has such an element of financial security in its operating method, it can usually get along with a smaller policyholder surplus than might be thought prudent if it operated on a nonparticipating basis.

Participating companies generally do have smaller surplus to premium ratios than nonparticipating companies. The security margin is not the only explanation for this statistical fact, but it is a matter of compelling interest to mutual managements.

Mutual companies can acquire the surplus with which to provide security for their member policyholders only from the members themselves. The members may either permit the surplus to accumulate through higher net costs, or leave a revolving fund of potential policyholder dividends in the company's hands as a contribution to the same purpose. The latter approach has had an acceptance that varies from place to place and time to time, but has in no way lost its importance.

The security margin is clearly no substitute for access to the capital market. Customers must be persuaded to pay higher initial premiums and expose the excess to the uncertainty of a subsequent dividend.

B. *To express the savings under Bureau rates that a mutual company's method of doing business makes possible.*

When an insurance company has a method of operation that permits it to sell for a lower net price than the majority of its competitors, and when there is a recognized system of list prices, either in the form of mandatory state-made rates or a manual of a rating organization in general use, then it may be convenient and desirable for the low cost company to use the difference between the established list prices and its operating requirements as its dividend margin. Such a company may evaluate this difference on a long range basis and then allow its dividend rate to remain unchanged as long as potential savings are unimpaired and no fortuitous disaster occurs.

This is the general situation in commercial fire and workmen's compensation. It extends to varying degrees to other lines. Where there exists a system of uniform or substantially uniform rates, whether by law, custom or economic necessity, it is convenient for the state administrators of the system,

the agents, the participating companies, and even their non-participating competitors to have net price differences expressed in dividends rather than through separate manuals.

Companies that operate on this basis, . . . and there are many of them . . . do not vary their dividend rates in terms of year to year results. They use their surpluses to absorb the ebbs and flows of the underwriting cycle, but always with the comfortable awareness that they could in the event of extremity bolster their resources by withholding dividends on policies in force. They behave this way partly because a relatively stable price position is demanded by the market and partly because they feel that equity among policyholders is better accomplished by following the broad base of experience that goes into ratemaking than by responding to their own more volatile results.

It may be well to illustrate this matter of equity, because some people have difficulty understanding why a mutual would ever knowingly declare dividends that would create an underwriting loss:

Assume that a mutual company has internal operating economies such that it can provide insurance for 10% less than the companies whose requirements determine the Bureau rates. In other words, if its net charges to customers are 10% less than those of the Bureau rates, it will do satisfactorily over a period of years, even though it may have operating losses in some years and gains in others.

Assume further that at any point of time the company has on its books 10,000 policyholders, all selected with whatever underwriting standards the company uses and all equally entitled, both in their own eyes and the eyes of the Directors they select, to this 10% saving that their chosen company is capable of delivering over a long range basis. None of them would vote to have it withheld from some and overpaid to others in terms of a lottery or some game of chance.

Each year new policyholders are being added and others are dropping out. There is considerable continuity, but the policyholder list is not the same in 1963 as it will be in 1968, even though the companies' method of operation and selection practices may be the same. However, neither the 1968 policyholders nor the 1963 policyholders feel that they are different or that they are entitled to any more or any less of the 10% saving than the other.

The larger claims that must be paid to or on behalf of a small minority of policyholders will fluctuate erratically from one year to the next. These fluctuations may make only a 5% dividend available from 1963 operations and a 15% dividend available from 1968 operations or visa versa. These differences do not correspond to any differences in the quality of the policyholders.

If the company were to make its dividends follow its recent claim outgo up and down the hills of fortuity, it would be taking a saving that its method of doing business made possible—and that all policyholders contributed to equally—and distributing it unequally, giving more to some lucky policy-

holders who happened to be on the books when the large claim frequency was light and taking away from essentially similar policyholders who happened to be on the books when the serious claim frequency was heavy.

Many mutual companies wish to avoid this effect. They do so by holding their dividend rates constant at the level of their long range savings potential. With such an objective they obviously will be paying dividends during years when they are suffering operating losses, whether the operating adversity comes from their own fortuitous experience or loss cycles in the Bureau rate level to which they have anchored themselves.

c. *To meet the requirements of law*

The uses of participation are occasionally required by statute: California has a uniform minimum rate law for workmen's compensation with specific provision in it for policyholder dividends to be paid only out of earned California workmen's compensation surplus. Dividends may not be declared (policyholders' net costs cannot be fixed) until after the insurer's California surplus status has been determined. All carriers, stock and mutual, are effectively obliged to conform to this system if they are to write workmen's compensation insurance in California. They must write their policies with rigidly administered rates that are generally high, and, if they are to achieve marketing acceptance, compete vigorously in dividend liberality after and only after they have established surplus sufficient to cover the participating returns.

New York group insurance is subject to laws built on a similar philosophy, although the group life rate is the only minimum rate applied with inter-company uniformity. However, "guaranteed retentions" are prohibited, the purpose of the prohibition being to prevent companies from committing themselves contractually to premium levels that subsequent developments might reveal to be inadequate.

In North Carolina for both fire and casualty and in Texas for casualty, refunds under participating policies are the only means of effecting price reductions to correspond with more economical methods of operation. The statutes of these states are controversial and the members of MICOFT would be in far from complete agreement on the desirability of things as they are. But in both states the legislatures have reviewed the subject within the last several years.

In several states there are no provisions in the laws for deviated workmen's compensation rates. In these states, policyholders' dividends are the only available mechanism for passing on savings to policyholders.

4. *Participating insurance also has some disadvantages.*

The most important disadvantages are:

1. The insurance buyer is not certain of his final net cost for a period of time.
2. The buyer generally must leave with the company for the policy period the amount which ultimately will be returned as a dividend. Commercial buyers resent the loss, however minor, of working capital. Personal buyers are not enthusiastic about higher initial prices.
3. Some items of outgo such as commissions, bureau assessments, etc., are traditionally expressed as rates of policy premium rather than rates of net premium after dividend returns.
4. Two step pricing necessarily involves more items of paper work than one step pricing. This disadvantage probably is more persuasive with regard to small premium unit business in electronic applications than it is with regard to business characterized by large premium units than would involve rating complexities anyway.

These disadvantages operate to keep a boundary around participating insurance. Taken together with a general movement away from bureaus and rate uniformity in some fields, they may be operating to reduce the percentage of business being written subject to participation, at least in personal insurance. It will be clear that, if there is no longer an established price list below which a policyholder dividend measures an easy to understand economy, then an otherwise participating underwriter has a less obvious choice to make between the participating and nonparticipating approaches. Even if the current trend in participation is downward, it is not proper to project it to an inference that the issue is disappearing. Some companies no longer need the margin of financial security provided by participation; others do. Some companies are voluntarily converting some of their business from a participating basis to a deviated basis; others are firmly convinced that their relations with their members, their credit policies, or their relations with their agency plants depend upon continuation of the dividend system. Some, because of heavy involvement in such states as Texas, North Carolina, and California or because of heavy involvement in Workmen's Compensation Insurance, couldn't shift away from participating insurance without giving up the right to serve very large numbers of their policyholders.

5. *Policyholders' dividends cannot be used to evade taxes*

Their utility for such a purpose is denied by the same economic regulation that prevents price cutting of any kind from becoming a troublesome problem of tax evasion.

Any corporation can take itself out of tax paying status for a short period of time by selling its wares below cost. Both stock and mutual insurance companies can do this. Among mutual insurance companies it can be done through initial premiums that are too low or through subsequent dividends that are too high. There are some state laws that might operate to discourage a sudden and deliberate

effort to sell below cost, but, like the laws against suicide, they are probably a less effective control than the general urge to survive. However, perhaps because of the customary connotations of the word "dividend" in stock corporations, or perhaps because mutuals stress their identification with their policyholders' interests, there may be some feeling that dividend paying mutuals can somehow do something with dividends to make their taxes less than they should be. To dispose of this possibility, let us examine the ways in which a mutual fire or casualty company can reduce its taxes under any of the total income tax laws that have been drafted or discussed to date:

1. *Tax exempt investment income*

Both stock and mutual companies can invest in tax exempt bonds, trading a lower gross yield for a higher net yield.

Both stock and mutual companies can invest some of their investable funds in equities and enjoy an 85 per cent dividend received credit.

The first of these devices is open to all taxpayers. It is used by fire and casualty companies, both stock and mutual, under the present law. It is not used extensively by the life insurance industry because so much of their investment income is removed from the tax stream that they are better served by a higher gross yield.

The second of these is available to all corporate taxpayers. Stock fire and casualty companies use it more extensively than do mutuals because they can afford to. Life companies cannot make much use of it because of state laws limiting their investments.

Tax exempt investment income is not a special privilege of mutual fire and casualty companies. If anyone were to suggest eliminating or reducing the tax exempt status of certain kinds of investment income, we would be among a large group that would oppose such changes for obvious self-serving reasons. However, this issue is an entirely separate one.

2. *Withdrawal from the market*

A mutual company could charge its policyholders sufficiently low net rates (either through dividends or deviations) so that its policyholders' surplus remained the same from one year to the next. Such a company, bounded by conventional surplus to volume relationships, would soon find itself serving a declining share of the market. Ultimately, as the dollar requirements of individual policyholders increased, it would find that it must serve a diminishing number of actual policyholders.

Since the market itself, when measured in dollars, customarily doubles in less than ten years, it will be seen that such a company would have effectively removed itself from competitive significance.

Such a company, regardless of its happy tax position, should be no threat to those who are concerned about competitive equality. Nor should the existence of such a company be of any worry to the watchers of the revenue.

In an expanding market such a company is simply turning over its share of the business to growth minded competitors, stock or mutual, who must finance just that much more capacity for the purpose.

These possible ways of limiting the tax a mutual company would pay under a total income approach have been apparent from the beginning. The first has nothing to do with the insurance business and the second has nothing to do with policyholder dividends. A company that wishes to sell below cost can do so at deviated rates as well as through overgenerous dividends.

6. *In a mutual company net premiums to policyholders are typically a little less than they otherwise would be as a result of investment income. For tax purposes, it should make no difference whether this saving is passed back through dividends or deviations.*

The cost of preparing and delivering a product or service always depends to some extent upon whether the customers pay before or after expenditures are made on their behalf. If the lag between cash-in and cash-out is large and enough, it may create an investment opportunity, and the use of the investment opportunity will offset other costs.

Magazine subscriptions are usually paid for in advance. This should reduce the cost of working capital to the publisher. Mortgage banks frequently collect insurance and real estate tax money from their clients in monthly installments spread out in advance of due dates. This money received before need should provide an investment opportunity which, theoretically at least, would make it possible for the mortgagee to charge lower interest rates.

Our investment operations are made possible by our underwriting operations and by the additional funds we have built up for policyholder protection which we call policyholder surplus. In a mutual company, with trivial exceptions, all of the policyholder surplus can be traced to earlier underwriting transactions and the investment of funds left with the company in the course of earlier underwriting transactions. There is no reason why we should do anything other than giving investment income whatever recognition we wish in determining net costs to our policyholders—either through dividends or deviated rates.

The formula in H.R. 10650 makes investment income a buffer for the Protection Against Loss Account if the company is operating on a deviating basis but exposes the Protection Against Loss Account directly if the company is operating on a participating basis. The connection between investment operations and underwriting operations is the same under both approaches to net cost. There is no excuse for the different tax treatment.

7. *It is not the function of the Federal Income Tax to modify the balance between the advantages and disadvantages of participating insurance.*

This premise seems so obvious there is some reluctance to elaborate on it at all. There is some concern that an elaboration may suggest the existence of a respon-

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sible counterview that must be met. We are unaware of any such counterview.

There is neither technical nor substantial reason why policyholder dividends must be considered to be anything other than an ingredient of income from customers.

Any impairment to the deductibility of dividends (or, more accurately, any inability to take into account the return of unused premiums when adding up income from customers) shifts the balance in favor of nonparticipating insurance.

If the impairment were material, the Directors of both stock and mutual companies that write participating insurance would have an obligation, one to its stockholders and the other to its policyholders, to avoid generating an unnecessary and artificial tax liability by continuing participating insurance in places where it could be converted to nonparticipating insurance.

The obstacles to a total transfer from participating to nonparticipating are agency relations, other operating methods, surplus sizes, and sundry state laws. Presumably, all of these obstacles could be overcome by some mutuals easily; most of them ultimately could be overcome by most mutuals with difficulty; some would remain insurmountable for some mutuals. If stock companies were not similarly treated, the state law changes might be extremely difficult, and mutuals would have to withdraw from some markets.

Such a transfer would not benefit the general public; it would have lost access to participating insurance. The Federal Treasury would gain nothing other than possible tax windfalls coming its way while participating insurance was in the process of being destroyed. It must be clear that no policyholder would leave an extra $1.00 with any company, stock or mutual, in exchange for the likelihood of a $.48 policyholder dividend, and no company operating in a competitive market would ask them to do so. If the impairment were great enough, mutuals would be obliged to either write nonparticipating insurance or withdraw from the market.

If the impairment were less material financially, we would have to approve it with almost equal vigor. We want no precedent for discrimination against participating insurance on the statute books.

8. *The financial magnitude of the discrimination is material for a large number of mutual companies.*

The greatest difference in tax and P.A.L. account accumulation occurs with companies that typically operate in such a way that all or most of their necessary surplus growth is provided by investment income. These are the companies that over a period of years tend to show only a small cumulative underwriting gain or loss and that tend to have an alternation of gains and losses in the individual years.

There are two exhibits appended in which the operation of the P.A.L. account is shown for such a company first if it operated on a dividend basis and second if it operated on a deviated basis. For both exhibits, the company has been delivering the same insurance protection to the same customers for the same net prices.

If the company were to operate on a dividend basis as shown on the first exhibit, the P.A.L. account would never amount to more than $730,000, less than 3% of a

typical year's losses. However, if the company were to operate on a deviation basis, the P.A.L. account would slowly rise to a little over $2,000,000 in the six-year period shown.

In those six years, the dividend paying company would have paid over a $1,000,000 more in Federal taxes than the deviating company.

9. *With this discrimination, the P.A.L. account cannot perform its intended function for dividend paying mutual companies that have fluctuating operating results.*

As will be apparent from the first exhibit, the P.A.L. account tends to be dissipated with year to year underwriting cycles. It is not permitted to accumulate for the more extraordinary losses.

A company that prices its insurance through policyholders' dividends finds itself using the account before its current outgo exceeds its current operating income. This is hardly compatible with the concept of an emergency fund.

10. *In all prior federal tax legislation, policyholder dividends have been recognized as reductions in the selling price to fire and casualty insurance buyers.*

1. Section 831 operates to give stock fire and casualty companies full credit for dividends to policyholders.
2. The present mutual fire and casualty law subtracts policyholder dividends from premiums initially paid by policyholders in the determinations of the 1% floor.
3. H.R. 10650, in every aspect except the operation of the P.A.L. account, treats policyholder dividends as an item to be subtracted from premiums in order to determine income from customers.

11. *The absurdity of differentiating between policyholder returns and other components of underwriting results in the P.A.L. account formula is made abundantly clear when specific situations are examined.*

Assume that a company is operating exclusively in California and that it is providing workmen's compensation insurance on a participating basis and personal automobile insurance on a net rate or deviated basis. Except by coincidence, the workmen's compensation policyholders would have no connection with the automobile owners that insured with the company, so the company would be under some obligation of equity to see that each group stood on its own.

Let us assume that the company pays to its California workmen's compensation policyholders only the dividends that can be made available by the companies' current California compensation underwriting results. (The law in California encourages this type of thinking, although the law permits dividends to be paid out of an accumulation of all prior excesses of income over outgo including the income from associated investment operations.)

Assume further that in the same year the companies' automobile insurance, written at deviated rates, contributes a large underwriting loss.

The combination of the two operations (workmen's compensation showing a small underwriting profit after dividends and automobile showing a large loss at deviated rates) is an underwriting loss for the company as a whole. The policyholders' dividends did not create the loss, since they were fully supported out of premiums from the policyholders' to whom they were paid.

Nevertheless, under H.R. 10650 the underwriting loss generated entirely by automobile insurance operations could not be applied against investment income without taking down the P.A.L. account first, solely because the company is also writing some workmen's compensation insurance and paying some fully earned dividends to policyholders on it.

There is no possible justification for treating policyholders' dividends differently than other ingredients of the selling price.

Exhibit 6

Question. It has been charged that mutual companies actually have used access to the capital market. Is that a fact?

Answer. No sir. Our mutuals by their very nonstock nature cannot sell any stock and must rely practically entirely upon their premium income and investment income. Of course, some States allow mutuals to accept what is called guarantee capital and both Federal and State courts have held that this guarantee capital is not capital stock of any kind but is merely nothing more than a debt subordinated to all other obligations and liabilities of every kind.

Anyone contributing guarantee capital can only receive legally limited interest and can never receive back more principal than he actually puts in.

At any rate the total amount of this guarantee capital received by some mutuals during the entire 20-year period of the present tax law is absolutely negligible and insignificant because it amounts—over the entire 20 years—to less than one-tenth of 1 percent of the mutuals' policyholders surplus.

Exhibit 7

Nearly Half of Our Mutuals Have Net Underwriting Losses

As shown below, out of the 350 mutuals of various sizes and types listed in "Best's Insurance Guide for 1961": 133 had net earned premium volumes of less than $1 million each; only 184 had net underwriting gains; almost as many, 166, had net underwriting losses.

This emphasizes the absolute necessity of permitting policyholder dividends as well as current ordinary losses and expenses to be paid out of total income (underwriting and investment income combined) rather than undertaking to restrict such payment to underwriting income alone, unless and until the loss funds are exhausted.

Classification of mutual companies (1960) (excluding factory mutuals and perpetuals) by net premium income size and underwriting gain

Net earned premiums	Number of companies	Federal tax incurred
Less than $1,000,000	133	$903,000
$1,000,000 to $4,999,000	126	3,943,000
$5,000,000 and over	91	34,141,000
Total	350	38,987,000
NET UNDERWRITING GAIN COMPANIES		
Less than $1,000,000	67	648,000
$1,000,000 to $4,999,000	68	2,200,000
$5,000,000 and over	49	20,753,000
Total	184	23,601,000
NET UNDERWRITING LOSS COMPANIES		
Less than $1,000,000	66	255,000
$1,000,000 to $4,999,000	58	1,743,000
$5,000,000 and over	42	13,388,000
Total	166	15,386,000

Exhibit 8

Question. What answer do you have to the argument that mutuals and stocks should be taxed identically alike because they are in direct competition with each other in the same line of business?

Answer. If that argument is valid, then the Congress would have to radically revamp its basic income tax structure so as to eliminate the existing recognized income tax distinction between individuals and partnerships on the one hand and stock corporations on the other. For example, consider two mercantile establishments in direct competition with each other in the same line of business with stores right next to each other. Even though their volume of business and expenses and net income before taxes might be absolutely the same, never-

theless their Federal income taxes would be vastly different. This distinction is soundly based upon the differences in structure and ownership between the two. Similarly, there is just as much fundamental difference between the structure and ownership of mutual companies on the one hand and stock companies on the other as other as there is between individuals and partnerships on the one hand and stock corporations on the other.

EXHIBIT 9

Question. Is it true that State taxation makes no significant dictinction between stock and mutual insurance companies? If so, should this fact have any material or significant bearing on Federal taxation?

Answer. The facts are that only three States (Mississippi, Louisiana, and Alaska) levy a tax on fire and casualty insurance companies under the label of "State income tax." Even in these States the tax is not assessed on income but rather is based on a specific percentage of whatever Federal income tax the individual company incurs. Obviously this is a recognition by these States of a significant difference between mutuals and stocks because their assessment is based upon Federal taxes levied under separate and distinct tax systems.

All the rest of the States levy taxes on stock and mutual companies on the basis of a sales tax which is in the nature of a license tax and is not an income tax. Furthermore practically all States exempt some types of mutual insurance companies.

EXHIBIT 10

Question. Do stock companies have any tax free "loss funds" which do not have to be used or exhausted before using investment income for payment of policyholder dividends?

Answer. Yes sir, they do. The records shows that more than one-fourth of the policyholders surplus of stock companies has come into them, entirely tax free, from the caiptal market. This corresponds to a similar proportion which our mutuals have heretofore been able to add to their policyholders surplus from tax-free premium income.

The pending House bill H.R. 10650 would deprive our mutuals of this source of addition to policyholders surplus. Instead the bill proposes a very limited protection against "loss funds" which would not only be smaller than net underwriting income but would also be largely nullified by the arbitrary ceiling and "forceout" provision and the provision that it must be exhausted before any part of investment income can be used for policyholder dividends.

Quite properly there are no such provisions against the tax free "loss fund" built up by stock companies through their access to the capital market and, as a matter of simple equity, there should not be any such provisions enacted or enforced against our mutuals.

EXHIBIT 11

Question. Do you think that the special loss fund allowances to life insurance companies in the Life Insurance Company Income Tax Act of 1959 and the special loss fund allowances to mutual thrift institutions in section 8 of the pending tax bill, H.R. 10650, are in any way improper or unreasonable?

Answer. No indeed. We have no criticism whatever of these loss fund allowances to life companies and to mutual thrift institutions. However, we do feel very strongly that our mutual fire and casualty insurance companies are fully entitled to similar equitable treatment. In other words, since these loss funds of the life companies and the mutual thrift institutions are not subject to either ceiling or arbitrary time forceout provisions, such provisions should not be included in the bill against our mutuals.

Furthermore, our mutuals should be permitted to use such part of investment income as may be necessary for the payment of policyholder dividends, losses, and expenses, just as such use is permitted to life insurance companies and to mutual thrift institutions.

EXHIBIT 12

Question. Does the pending bill give to mutuals any deduction or tax credit of any kind on group accident and health insurance business similar to the 2-percent tax credit deduction given to life insurance companies for that type of business?

Answer. No, sir, it does not, although it certainly should do so. Both stock and mutual fire and casualty insurance companies write group health and accident insurance just as the life insurance companies do. Stock and mutual fire and casualty insurance companies deserve the same allowance for this type

of insurance which involves such dangerous concentration of risks (regardless of what type of company writes it). This group health and accident insurance is usually a matter of competitive negotiation. We have no criticism of the 2 percent tax credit granted to the life companies but we do urge most earnestly that the fire and casualty companies, both stock and mutual, are entitled to similar equitable consideration.

EXHIBIT 13

Question. If the ceiling and 5-year "force out" provisions are eliminated from H.R. 10650, would the "Protection Against Loss Account" become unreasonably large?

Answer. No, sir. Our actuaries have carefully tested what the experience would have been during the most recent decade (1951-60) which was a representative average period including war years and peace years, prosperous years and heavy loss years. Their tests showed that while the PAL would sometimes have gone above 10 percent of premiums, it would have averaged only about 6 percent.

It must be remembered that every time the fund is drawn upon for excess losses the amount thus withdrawn increases the company's taxable income for that year. And, furthermore, the income derived by the company from investment of the fund increases the company's investment income.

Every company, large, medium, small, has some years of heavy excess losses which would use up substantial portions of the fund. In the course of years, greater in some cases and less in others, as a result of excess loss experience, all moneys transferred into the fund could be expected eventually to reenter the tax picture. Meantime the fund acts as a very necessary bulwark for public protection.

So the Treasury would derive tax revenue both ways from the fund.

And most important of all, the fund cannot be used for anything except insurance losses.

EXHIBIT 14

Question. Has the Treasury Department heretofore advocated shifting mutual fire and casualty insurance companies over onto a total income approach basis?

Answer. No, sir, not until the hearings began last year on the pending House bill. Up until that time, for nearly 20 years, since 1942, various groups of antimutual agitators from time to time attacked the mutual tax status. These various groups, led, financed, and controlled by Allstate Insurance Co. in recent years, presented their arguments to congressional committees and to the Treasury. At no time since 1942 did the Treasury ever advocate or support or even approve of any proposed change in the taxation status of our mutuals until last year when control of the Treasury Department shifted to its present hands.

EXHIBIT 15

Question. Do you think our tax laws should provide for some form of disaster relief for mutual insurance companies?

Answer. After a devastating hailstorm, windstorm, tornado or flood, it is not unusual for the President of the United States or the Governor of a State to declare the affected territory a disaster area and to provide financial relief to individuals and industries who carried no insurance or insufficient insurance to cover the damage. But not one of you has ever heard of the Federal Government or the State providing financial assistance to the insurance company who carried a large portion of the liability in the area and paid for a large portion of the damage. Insurance companies are supposed to take care of themselves and build up emergency funds to pay their losses regardless of the amount. If, because of excessive loss payments, this emergency fund or surplus is depleted below a specified amount, the insurance commissioner of the State is required to declare the company insolvent. The only source of funds available to mutual companies for building adequate emergency funds is from "underwriting gain," the amount of premium collected in excess of losses and expenses. It will be impossible for a mutual company to build such a fund or to rebuild such a fund after a catastrophe if 52 cents out of every dollar of underwriting gain is taken away in the form of Federal income tax. Underwriting loss can be carried back only 3 years and forward 5 years for credit against underwriting gain. It is entirely possible for a company to experience small underwriting gains for a 3-year period, then suffer a catastrophe followed by 5 years of modest underwriting gain. In such a situation the company would receive very little relief from the carryback carry-forward provision.

EXHIBIT 16

STATISTICS FROM SPECTATOR "INSURANCE BY STATES"

Pure Crop-Hail Loss Ratio to Earned Premium for All Companies on All Liability Written in the Year of 1956.

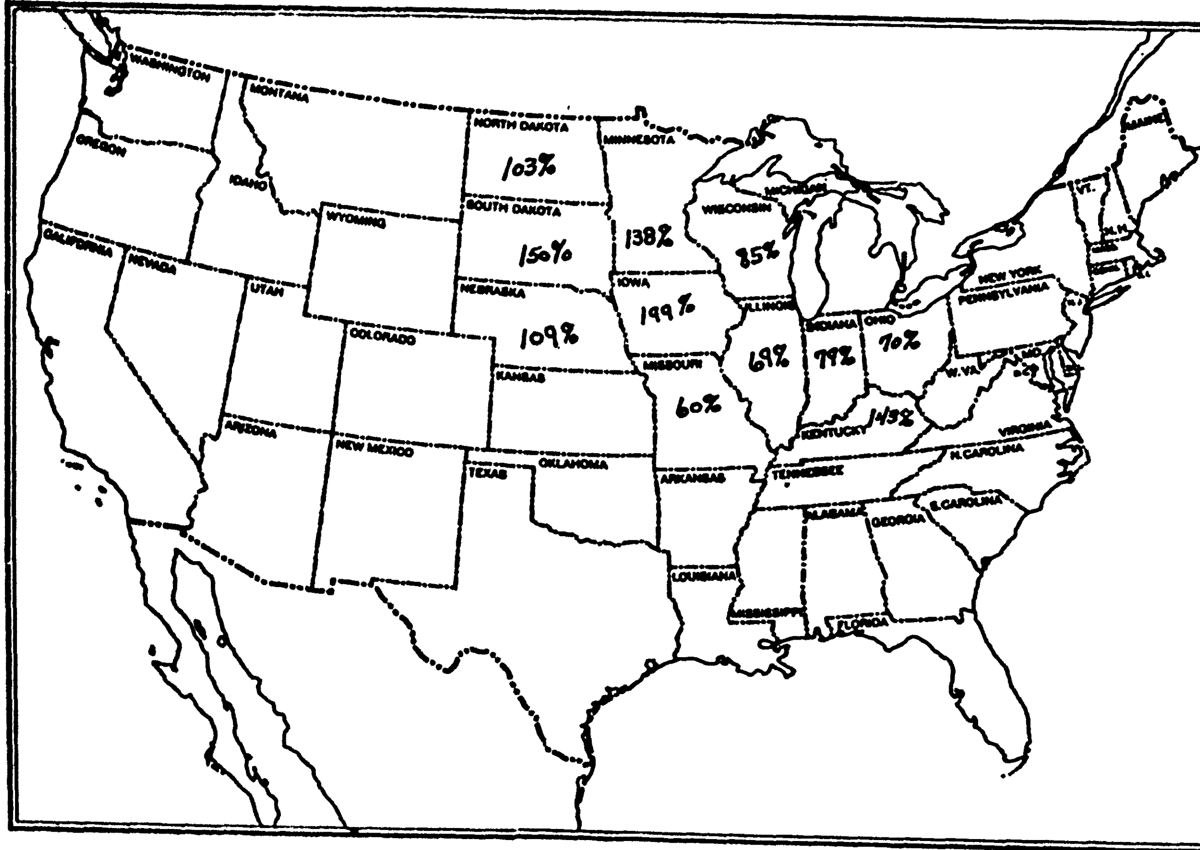

EXHIBIT 17

ALL STOCK COMPANIES (LISTED IN BEST'S INSURANCE GUIDE)

Amount of investment income used tax free to pay policyholders' dividends

[In thousands of dollars]

Company	Year	Underwriting gain or loss	Policyholders dividends	Amount of investment income used tax free to pay policyholders dividends
Affiliated Fire Mutual, Rhode Island	1956	537	758	221
	1957	246	498	252
	1958	406	469	63
	1960	50	421	371
All American C & Casualty, Illinois	1955	5	21	16
Alliance Assurance (England), New York	1957	−271	1	1
	1958	−18	1	1
	1959	−136	1	1
Allied Fire, New York	1951	113	118	5
	1952	119	120	1
	1954	66	121	55
	1955	46	118	72
Allied Insurance, California	1958	113	139	26
	1959	179	211	32
	1960	121	138	17
Allstate Insurance Co., Illinois	1956	−1,979	1,619	1,619
	1957	−1,142	1,864	1,864
American Auto, New Jersey	1957	−2,015	127	127
	1958	−958	85	85
American Casualty, Pennsylvania	1958	−1,159	9	9
	1959	−1,285	10	10
	1960	−1,504	13	13
American Empire, Minnesota	1956	−312	1	1
	1957	−122	2	2
	1958	−61	8	8
	1959	−137	17	17
	1960	−162	30	30
American Fire & Casualty, Florida	1951	8	31	23
American Hardware Industry, Minnesota	1951	−14	25	25
American, New Jersey	1957	−11,769	238	238
	1958	−1,796	159	159
American Insurors, Texas	1959	−21	2	2
American Liberty, Alabama	1959	−246	5	5
	1960	−543	13	13
American Motorists, Illinois	1951	2,519	2,827	308
	1956	4,897	4,947	50
	1957	3,538	4,586	1,048
	1959	3,880	4,619	739
American Policyholders, Massachusetts	1951	396	524	128
	1952	144	213	69
American Premier, Minnesota	1957	−10	1	1
	1958	−18	3	3
	1959	−40	4	4
American Star, California	1959	−200	1	1
	1960	−108	1	1
American Universal, Rhode Island	1958	−132	1	1
Anchor Casualty, Minnesota	1951	−201	139	139
	1952	−352	142	142
	1956	−973	77	77
	1957	−183	107	107
	1958	−186	133	133
	1959	−265	131	131
	1960	−105	130	130
Appalachian, Rhode Island	1953	1	8	7
Associated Employers, Texas	1951	−180	62	62
	1952	42	75	33
	1955	−140	50	50
	1959	−112	11	11
Associated Independent, New Jersey	1951	−708	518	518
	1952	−58	725	725
	1957	−4,314	32	32
	1958	−240	21	21
Assurance Co. of America, New York	1951	−111	13	13
	1954	18	42	24
	1955	−31	62	62
	1956	−366	67	67
	1957	−1,022	166	166
Automobile Club, Ohio	1951	−30	2	2
Bankers & Shippers, New York	1956	−123	2	2
	1957	−900	4	4
	1958	−197	6	6
	1959	−220	8	8
	1960	−506	11	11

Amount of investment income used tax free to pay policyholders' dividends—Continued

[In thousands of dollars]

Company	Year	Underwriting gain or loss	Policyholders' dividends	Amount of investment income used tax free to pay policyholders' dividends
Bay State, Massachusetts	1957	167	170	3
	1958	87	168	81
	1959	172	182	10
Beneficial Fire & Casualty, California	1951	−60	4	4
Bituminous Casualty, Illinois	1951	−28	24	24
California Comp., California	1951	138	458	320
	1952	−27	131	131
	1954	545	621	76
	1956	35	404	369
	1957	−714	161	161
	1958	−154	422	422
	1959	43	171	128
	1960	193	234	41
California Food Industries, California	1960	97	104	7
Casualty Insurance Co., California	1951	11	25	14
	1959	147	160	13
Casualty Underwriters, Minnesota	1957	19	40	21
	1958	−207	50	50
	1959	−191	49	49
Civil Service, California	1955	−256	106	106
	1956	−320	82	82
Colonial Insurance, California	1953	−86	5	5
	1956	−282	21	21
	1957	−78	11	11
	1958	10	20	10
Commercial Standard, Texas	1957	−914	14	14
	1960	−491	31	31
Continental Casulty, Illinois	1957	−2,024	222	222
Delta Fire and Casualty, Louisiana	1954	23	25	2
	1955	−16	29	29
Dixie Fire and Casualty, South Carolina	1951	−41	27	27
	1952	18	30	12
	1955	251	345	94
	1956	412	465	53
	1958	223	690	467
	1959	213	589	376
	1960	366	516	150
Eastern Casualty, New York	1952	12	23	11
Educators Auto, Texas	1957	22	37	15
	1958	45	55	10
Employers Casualty, Texas	1952	375	932	557
	1956	1,039	1,068	29
	1957	179	1,260	1,081
	1958	−539	1,251	1,251
Employers Insurance, Alabama	1956	66	420	354
	1957	−106	169	169
Employers Reinsurance, Missouri	1951	−7,431	450	450
Enterprise, California	1960	−158	117	117
Fireman's Fund Inc., California	1955	−208	9	9
Fireman's Fund Inc., California	1955	−480	41	41
	1956	−15,798	164	164
	1957	−9,132	215	215
	1959	−1,110	146	146
	1960	−810	243	243
Franklin Casualty, Oklahoma	1955	−8	1	1
General Casualty of America, Washington	1951	−418	28	28
	1952	−2,543	30	30
General Fire and Casualty, New York	1951	−281	167	167
	1952	212	289	77
General Insurance of America, Washington	1956	−935	3,838	3,838
	1957	2,329	4,261	1,932
Guarantee Insurance, California	1951	−13	73	73
	1954	−2	41	41
	1955	−596	148	148
	1956	−1,285	217	217
	1957	−1,828	70	70
Harbor, California	1958	−138	12	12
	1959	−568	8	8
Helvetia Swiss (Switzerland), Alabama	1958	−262	1	1
	1959	−187	5	5
	1960	−185	13	1
				3

Amount of investment income used tax free to pay policyholders' dividends—Continued

[In thousands of dollars]

Company	Year	Underwriting gain or loss	Policyholders' dividends	Amount of investment income used tax free to pay policyholders' dividends
Home F. & M., California	1956	−2,893	30	30
	1957	−1,672	39	39
	1959	−203	27	27
	1960	−148	44	44
Industrial Ind., California	1957	1,550	1,935	385
	1958	−43	1,505	1,505
	1959	1,352	2,706	1,354
	1960	1,313	1,341	28
International Service, Texas	1952	208	233	25
	1956	255	476	221
	1958	329	350	21
	1960	259	484	225
Jersey, New York	1956	−80	1	1
	1957	−576	2	2
	1958	−128	4	4
	1959	−142	5	5
	1960	−323	7	7
Keystone Insurance, Pennsylvania	1951	748	973	225
	1952	908	1,106	198
	1957	1,453	1,728	275
	1958	1,230	1,786	556
	1959	1,282	1,874	592
Lackawanna, Pennsylvania	1956	−65	15	15
Liberty Insurance, Texas	1951	−15	77	77
	1958	−85	295	295
	1959	−66	152	152
Liberty National, Idaho	1951	−50	2	2
	1952	−112	1	1
Manchester Insurance and Indemnity, Ohio	1956	−24	5	5
	1957	−4	3	3
Manufacturers & Merchants Indemnity, Ohio	1951	35	116	81
	1952	−491	65	65
	1953	58	66	8
	1955	−63	56	56
Maryland National, Maryland	1956	−78	4	4
	1957	−18	8	8
	1958	−23	12	12
	1960	−11	21	21
Massachusetts Bay, Massachusetts	1960	−21	1	1
Merchants Fire, New York	1956	−134	3	3
	1957	−1,719	1	1
	1958	−471	15	15
	1959	−148	14	14
	1960	−895	10	10
Merchants Ind., New York	1956	−42	1	1
	1957	−110	4	4
	1958	−30	4	4
	1959	−224	3	3
Merchants Property, Indiana	1956	326	484	158
	1957	371	380	9
Mid-Century, California	1953	−59	26	26
	1954	3	18	15
	1955	−10	5	5
	1956	−1	18	18
	1957	10	19	9
	1958	−102	9	9
	1959	−81	7	7
	1960	−2	7	7
Midwestern Insurance, Oklahoma	1951	−315	9	9
Millers National, Illinois	1952	172	223	51
	1954	−30	266	266
	1956	−111	327	327
	1957	141	322	181
	1960	228	378	150
National Auto and Casualty, California	1951	−671	32	32
	1953	29	35	6
	1954	53	188	135
	1955	42	134	92
	1956	−953	130	130
	1959	136	172	36
National Farmers, Colorado	1951	98	156	58
	1952	−36	58	58
	1953	36	174	138
	1956	−83	74	74
	1957	−1,044	89	89
	1958	−902	43	43

Amount of investment income used tax free to pay policyholders' dividends—Continued

[In thousands of dollars]

Company	Year	Underwriting gain or loss	Policyholders' dividends	Amount of investment income used tax free to pay policyholders' dividends
National Grange Fire, New Hampshire	1954	109	146	37
	1955	129	142	13
National Surety, California	1956	−3,560	37	37
	1957	−2,058	48	48
	1959	−250	33	33
	1960	−183	55	55
Newfoundland American, Newfoundland	1959	−10	1	1
	1960	−6	2	2
New Jersey Manufacturers Casualty, New Jersey	1951	2,692	4,471	1,779
	1952	2,222	4,270	2,048
	1957	5,113	6,004	891
	1958	5,915	6,039	124
	1959	4,680	5,472	792
	1960	3,794	6,190	2,396
New Jersey Manufacturers Indemnity, New Jersey	1959	2,213	3,200	987
	1960	3,828	3,842	14
Northern, New York	1954	−329	100	100
	1955	12	237	225
	1957	−753	528	528
	1958	12	511	499
	1959	−1,441	626	626
	1960	−2,077	43	43
Northern Security, Vermont	1956	−4	7	7
	1958	28	49	21
	1960	9	21	12
Oregon Automobile, Oregon	1957	−453	11	11
Oregon Farm Bureau, Oregon	1952	19	54	35
	1955	58	65	7
Pacific Automobile, California	1951	−131	16	16
	1953	−81	10	10
Pacific Employers, California	1951	−706	809	809
	1957	563	982	419
Pacific Indemnity	1951	−1,649	288	288
	1952	−355	23	23
	1956	−1,122	419	419
	1957	−2,923	233	233
	1958	−1,555	294	294
	1959	−155	12	12
Pacific Insurance, Hawaii	1956	−40	2	2
	1957	−1,026	4	4
	1958	−224	7	7
	1959	−250	10	10
	1960	−576	13	13
Peerless Insurance, New Hampshire	1951	−300	20	20
Pennsylvania General, Pennsylvania	1956	−389	1	1
	1957	−769	5	5
	1958	−536	9	9
	1959	−283	22	22
Pennsylvania Manufacturers Association Casualty, Pennsylvania.	1951	3,573	4,209	636
	1956	5,630	5,905	275
	1957	5,985	6,138	153
	1958	5,430	6,133	703
	1959	5,816	6,451	635
	1960	5,397	6,379	982
Pennsylvania Manufacturers Association Fire, Pennsylvania.	1955	115	127	12
	1957	154	165	11
	1958	243	248	5
Preferred Risk Insurance, Arkansas	1955	1	3	2
	1957	−72	5	5
	1958	−59	9	9
	1959	−108	6	6
	1960	−88	7	7
Protective Fire & Casualty, Nebraska	1957	−134	4	4
	1958	−78	5	5
	1959	−29	6	6
Republic Independent (Ariz.), California	1951	−47	8	8
	1957	−251	7	7
	1958	2	20	18
	1959	−21	18	18
Reserve Insurance, Illinois	1955	10	16	6
Safeco Insurance of America, Washington	1956	−1,601	69	69
St. Paul F. & M., Minnesota	1957	−4,945	25	25
St. Paul Mercury, Minnesota	1957	−708	14	14
Sea Insurance (England), New York	1957	5	3	3

Amount of investment income used tax free to pay policyholders' dividends—Continued

[In thousands of dollars]

Company	Year	Underwriting gain or loss	Policyholders' dividends	Amount of investment income used tax free to pay policyholders' dividends
Selective Insurance, Ohio	1954	−6	1	1
	1955	−8	3	3
	1956	−447	31	31
	1957	−229	11	11
	1958	−447	14	14
Sentinel Indemnity, Texas	1959	11	12	1
	1960	0	23	23
Shamrock Casualty, New York	1957	15	35	20
	1958	36	38	2
Southern Farm Bureau Casualty, Mississippi	1951	494	629	135
	1953	2,295	2,630	335
	1954	2,911	3,021	110
	1955	3,074	3,200	126
	1956	2,472	2,600	128
	1957	1,888	2,047	159
	1958	2,857	3,040	183
	1959	3,382	3,604	222
	1960	3,328	3,573	245
Southern Fire & Casualty, Tennessee	1959	−202	3	3
	1960	−46	6	6
Southern General, Georgia	1957	−838	2	2
	1958	−522	3	3
	1959	−338	1	1
Southern Home, South Carolina	1957	−44	2	2
	1958	−141	1	1
	1959	−30	3	3
	1960	−124	2	2
Southwestern Indemnity (Texas), Michigan	1956	−61	3	3
State Farm Fire & Casualty, Illinois	1953	−782	19	19
	1954	−159	28	28
	1955	34	58	24
	1956	−1,735	114	114
Stock Insurance Co. of the Green Tree, Pennsylvania	1960	−65	11	11
Textile Insurance, North Carolina	1951	2	34	32
	1956	−21	123	123
	1957	−21	105	105
Traders and General, Texas	1951	−5	58	58
	1952	−423	51	51
	1955	24	46	22
	1956	−1,573	39	39
	1957	−188	57	57
	1958	13	134	121
	1959	78	188	110
	1960	−316	157	157
Transcontinental, New York	1960	65	76	11
Transit Casualty, Missouri	1955	−161	38	38
	1957	27	30	3
Transport Indemnity, California	1951	926	1,100	174
	1959	30	129	99
	1960	603	611	8
Transport Insurance, Texas	1958	1,100	1,416	316
Underwriters Insurance, Illinois	1951	−46	38	38
	1952	−31	41	41
	1953	2	56	54
	1956	30	58	28
	1957	−266	64	64
	1958	−173	72	72
	1959	−226	52	52
United Fire & Casualty, Iowa	1956	−212	15	15
	1957	−98	23	23
	1958	13	34	21
	1959	−34	43	43
	1960	−89	47	47
Universal Surety, Nebraska	1959	−174	3	3
	1960	−134	24	24
Universal Underwriters, Missouri	1959	198	437	239
	1960	346	516	170
Utilities Insurance, Missouri	1951	−35	28	28
	1956	−86	23	23
	1957	−36	11	11
	1958	−42	17	17
	1960	−103	11	11
Valley Forge, Pa	1958	−497	4	4
	1959	−551	4	4
	1960	−645	6	6

Amount of investment income used tax free to pay policyholders' dividends—Continued

[In thousands of dollars]

Company	Year	Underwriting gain or loss	Policyholders' dividends	Amount of investment income used tax free to pay policyholders' dividends
Vanguard Insurance, Texas	1956	−64	10	10
	1957	−102	22	22
	1958	−96	34	34
	1959	−106	67	67
	1960	−46	94	94
Vigilant	1956	−88	1	1
	1957	−127	2	2
	1960	−133	5	5
West American (Calif.), Ohio	1951	−2	7	7
	1952	−147	12	12
Western Pacific, Washington	1953	−87	26	26
	1954	1	27	26
	1955	−9	59	59
	1956	−165	75	75
	1957	−72	16	16
	1960	25	47	22
Zenith National, California	1953	−28	25	25
	1954	−22	87	87
	1956	−83	202	202
	1957	115	196	81
	1958	146	203	57
	1959	116	150	34
	1960	57	200	143
Zurich Insurance (Switzerland), Illinois	1958	−3,602	47	47
	1959	−827	133	133
	1960	−784	167	167

Exhibit 18

Member Companies of the Mutual Insurance Committee on Federal Taxation

April 1962

ALABAMA

General Mutual Insurance Co. of Alabama, Birmingham.

ARKANSAS

American Mutual Insurance Co., Morrilton.
Arkansas State Association of Mutual Insurance Cos., Fayetteville.
Farmers Home Mutual Fire Insurance Co., Inc., Paragould.
Farmers Mutual Insurance Co., Benton County, Gentry.
Farmers Protective Insurance Co., Stuttgart.
Farmers Union Mutual Insurance Co., Little Rock.
Northwest Arkansas Farmers Mutual Tornado Insurance Co., Fayetteville.
Washington County Farmers Mutual Fire Insurance Co., Fayetteville.

CALIFORNIA

Farmers Mutual Fire Insurance Co. of Mendocino County, Fort Bragg.
Farmers' Mutual Fire Insurance Co. of San Joaquin County, Stockton.
Los Angeles Mutual Insurance Co., Los Angeles.
Mutual Fire Association of Tulare County, Visalia.
Orange County Farmers Mutual Fire Insurance Co., Santa Ana.
San Diego County Mutual Fire Insurance Co., San Diego.
Santa Clara County Fire Insurance Co., San Jose.
Sonoma County Farmers' Mutual Fire Insurance Co., Santa Rosa.
Ventura County Mutual Fire Insurance Co., Ventura.

COLORADO

Farmers Union Mutual Insurance Co., Denver.

CONNECTICUT

Middlesex Mutual Assurance Co., Middletown.
Mutual Insurance Co. of Hartford, Hartford.
New London County Mutual Fire Insurance Co., Norwich.
The Patrons' Mutual Fire Insurance Co., Glastonbury.

DELAWARE

Farmers' Mutual Insurance Co. of Delaware, Wilmington.
Kent County Mutual Insurance Co., Dover.

DISTRICT OF COLUMBIA

Bankers Mutual Insurance Co.

GEORGIA

Cotton States Mutual Insurance Co., Atlanta.
Coweta Mutual Fire Insurance Co., Newnan.

IDAHO

Grange Mutual Life Co., Nampa.
Idaho State Association of Mutual Insurance Cos., Gooding.
Snake River Mutual Insurance Co., Boise.
Twin Falls County Mutual Fire Insurance Co., Buhl.

ILLINOIS

Albion District Mutual Windstorm & Cyclone Insurance Co., Albion.
American Manufacturers Mutual Insurance Co., Chicago.
American Mutual Reinsurance Co., Chicago.
Banner Mutual Insurance Co., Chicago.
Belleville, St. Clair County Farmers' Mutual Fire Insurance Co., Belleville.
Belvidere Farmers Mutual Fire & Lightning Insurance Co., Belvidere.
Bishop Township Mutual Fire Insurance Co., Dieterich.
Buffalo Mutual Fire Insurance Co., Polo.
Camp Point Farmers Mutual County Fire Insurance Co., Camp Point.
Carthage District Mutual Cyclone Insurance Co., Carthage.
Cass County Mutual Fire Insurance Co., Virginia.
Coles County Grange Insurance Co., Charleston.
Country Mutual Insurance Co., Bloomington.
Dix Mutual County Fire Insurance Co., Paxton.
Dunham & Chemung County Mutual Fire Insurance Co., Harvard.
East St. Louis District Mutual Cyclone Insurance Co., Nashville.
Elmira Mutual County Fire Insurance Co., Toulon.
Federal Mutual Insurance Co., Decatur.
Florists' Mutual Insurance Co., Edwardsville.
Forreston County Mutual Fire Insurance Co., Forreston.
Founders Mutual Casualty Co., Chicago.
Garden Plain Mutual Insurance Co., Fulton.
Grand Rapids, Brookfield & Fall River Home Insurance Co., Marseilles.
Green Garden Farmers Fire Insurance Co., Monee.
Greene County Mutual County Fire Insurance Co., Greenfield.
Hamlet Mutual Fire & Lightning Insurance Co., Reynolds.
Harmony Mutual County Fire Insurance Co. of Carthage, Carthage.
Helvetia Township Mutual Fire Insurance Co., Highland.
Illinois Mutual Fire Insurance Co., Belvidere.
Iuka Mutual Marion County Fire Insurance Co., Iuka.
Jacksonville Farmers Mutual County Fire Insurance Co., Jacksonville.
Jerseyville Mutual County Fire Insurance Co., Jerseyville.
Kane County Mutual Fire Insurance Co., Geneva.
Lancaster Township Mutual Fire Insurance Co., Freeport.
Lincoln Mutual County Fire Insurance Co., Mount Morris.
Louisville Clay County Farmers Mutual Fire Insurance Co., Flora.

Lumbermen's Mutual Casualty Co., Chicago.
Lutheran Mutual Fire Insurance Co., Chicago.
Lynnville & Monroe Township Mutual Fire Insurance Co., Lindenwood.
Macoupin County Mutual Fire Insurance Co., Carlinville.
Marshall Mutual County Fire Insurance Co., Marshall.
Mendota, Troy Grove & Clarion Farmers' Insurance Co., Mendota.
Menominee & Vinegar Hill Mutual Fire Insurance Co., East Dubuque.
Millers' Mutual Insurance Association of Illinois, Alton.
The Montgomery County Mutual Fire Insurance Co., Hillsboro.
Mount Carroll Mutual Fire Insurance Co., Mount Carroll.
Mount Sterling Mutual County Fire Insurance Co., Mount Sterling.
Mutual County Fire Insurance Co., Mount Prospect.
Mutual Reinsurance Bureau, Belvidere.
New Lenox Mutual County Fire Insurance Co., New Lenox.
Nunda-Algonquin Mutual Fire Insurance Co., Crystal Lake.
Pana-Hillsboro District Cyclone Mutual Insurance Co., Hillsboro.
Pecatonica Township Mutual Fire Insurance Co., Pecatonica.
Pesotum Township Mutual Fire Insurance Co., Sadorus.
Prophetstown Farmers Mutual Insurance Co., Prophetstown.
Rockford District Mutual Tornado Insurance Co., Rockford.
Rockford Swedish Mutual Fire Insurance Co., Rockford.
State Farm Mutual Automobile Insurance Co., Chicago–Bloomington.
Staunton Township Mutual Fire Insurance Co., Mount Olive.
Stronghurst Mutual County Fire Insurance Co., Stronghurst.
Ursa, Mendon & Lima Mutual Fire Insurance Co., Mendon.
Vandalia Mutual County Fire Insurance Co., Vandalia.
Waltham, Utica & Ophir Township Mutual Fire Insurance Co., Utica.
Woodford County Mutual Fire Insurance Co., Eureka.

INDIANA

Bartholomew County Farmers Mutual Fire & Lightning Insurance Co., Columbus.
Bartholomew County German Mutual Insurance Co., Columbus.
The Boone Farm Mutual Insurance Co., Lebanon.
Brotherhood Mutual Insurance Co., Fort Wayne.
Citizens Mutual Fire Insurance Co., Richmond.
Farmers Home Mutual Insurance Co., Vincennes.
Farmers Mutual Fire Insurance Co. of Jay County, Portland.
Farmers Mutual Fire Insurance Co. of Johnson &Shelby Counties, Franklin.
Farmers Mutual Fire Insurance Co. of LaPorte County, LaPorte.
Farmers Mutual Insurance Co. of Clay Township, Spencer County, Lincoln City. City.
Farmers Mutual Insurance Co. of Huntington, Wabash & Wells Counties, Huntington.
Farmers Mutual Insurance Co. of Tipton County, Tipton.
Farmers Mutual Relief Association of Kosciusko County, Warsaw.
German Mutual Insurance Co. of Warrick County, Chandler.
Gibson, Warrick & Vandenburg Farmers Mutual Insurance Co., Haubstadt.
Grain Dealers Mutual Insurance Co., Indianapolis.
Indiana Farmers Mutual Insurance Co., Indianapolis.
Indiana Lumbermen's Mutual Insurance Co., Indianapolis.
Indiana Mutual Hail Insurance Co., Indianapolis.
Indiana Union Mutual Insurance Co., Indianapolis.
Jefferson County Patrons Mutual Fire Insurance Co. of Madison, Madison.
Lawrence County Farmers Mutual Insurance Co., Bedford.
Meridian Mutual Insurance Co., Indianapolis.
Michigan City Mutual Fire Insurance Co., Michigan City.
The Mutual Fire Insurance Co. of Vanberburgh, Posey, Gibson & Warrick Counties, Evansville.
Mutual Home Fire Insurance Co., Santa Claus.
Posey County Mutual Fire Insurance Co., Mount Vernon.
Remington Farmers Mutual Insurance Co., Remington.
Rockcreek Township Farmers Mutual Insurance Co., Uniondale.
Switzerland & Ohio Counties Patrons Mutual Fire Insurance Co., Rising Sun.
Terre Haute Mutual Fire Insurance Co., Terre Haute.

IOWA

Agricultural Mutual Insurance Association, Des Moines.
Allied Mutual Insurance Co., Des Moines.
American Mutual Insurance Association, Davenport.
American Mutual Insurance Association of Wheatland, Clinton County, Wheatland.
Bohemian Mutual Insurance Association of Tama County, Tama.
Boone Farmers Mutual Insurance Association, Boone.
Brown Township Mutual Insurance Association, Marion.
Buena Vista Mutual Insurance Association, Alta.
Butler County Mutual Insurance Association, New Hartford.
Calhoun Mutual Insurance Association, Lake City.
Castle Grove Mutual Insurance Association of Monticello, Jones County, Monticello.
Cerro Gordo Mutual Insurance Association, Mason City.
Clay Mutual Insurance Association, Spencer.
Dallas Mutual Insurance Association, Dallas Center.
Danish Mutual Insurance Association of Black Hawk County, Cedar Falls.
Danish Mutual Fire Insurance Association of Shelby County, Elk Horn.
Delaware County Mutual Insurance Association, Manchester.
Dickinson County Farmer's Mutual Insurance Association, Spirit Lake.
The Druggists' Mutual Insurance Co., Algona.
Eden Mutual Insurance Association, Benton County.
Employers Mutual Casualty Co., Des Moines.
Farmers Elevator Mutual Insurance Co., Des Moines.
Farmers Mutual Aid Association of Jackson & Clinton Counties, Preston.
Farmers Mutual Insurance Association, Adams County, Corning.
Farmers Mutual Insurance Association of Birmingham, Van Buren County, Birmingham.
Farmers Mutual Insurance Association of Black Hawk County, Hudson.
Farmers Mutual Insurance Association of Central Iowa, Roland.
Farmers Mutual Insurance Association of Clinton & Adjoining Counties, Wheatland.
Farmers Mutual Insurance Association of Crawford County, Schleswig.
The Farmers Mutual Fire & Lightning Insurance Association of Emmet & Adjoining Counties, Armstrong.
Farmers' Mutual Insurance Association of Garnavillo, Clayton County, Garnavillo.
Farmers Mutual Insurance Association of Iowa, Rockford.
Farmers Mutual Fire Insurance Association, Madison County, Winterset.
Farmers Mutual Insurance Association, Mitchell County, Osage.
Farmers Mutual Insurance Association of O'Brien County, Hartley.
Farmers Mutual Insurance Association of Osceola County, Sibley.
Farmers Mutual Insurance Association of Palo Alto County, Emmetsburg.
Farmers Mutual Insurance Association of Scott County, Davenport.
Farmers Mutual Insurance Association of Sharon, Johnson County, Iowa City.
Farmers Mutual Insurance Association of Sioux and Adjoining Counties, Hull.
Farmers Mutual Insurance Association, Washington County, Washington.
Farmers Mutual Fire Insurance Association of Webster and Adjoining Counties, Fort Dodge.
Farmers Mutual Insurance Association of Winnebago County, Lake Mills.
Farmers Mutual Hail Insurance Co. of Iowa, Des Moines.
Farmers Mutual Reinsurance Co., Grinnell.
Farmers State Mutual Hail Association of Estherville, Iowa, Estherville.
First Maxfield Mutual Insurance Association (Brewer County), Denver.
Franklin County Farmers Mutual Insurance Association, Hampton.
Fremont Mutual Insurance Association, Sidney.
German Farmers Mutual Insurance Association of Allamakee County, Waukon.
German Mutual Insurance Association, Calhoun County, Pomeroy.
German Mutual Insurance Association, Jones County, Monticello.
Glidden Mutual Insurance Association, Glidden.
Grundy Mutual Insurance Association, Grundy Center.
Hancock Mutual Insurance Association, Garner.
Harrison Mutual Insurance Association, Logan.
Henry County Mutual Insurance Association, Mount Pleasant.
Home Mutual Insurance Association, Manning.

Humboldt Mutual Insurance Association, Humboldt.
Iowa Hardware Mutual Insurance Co., Mason.
Iowa Mutual Tornado Insurance Association, Des Moines.
Iowa National Mutual Insurance Co., Cedar Rapids.
Jasper Mutual Insurance Association, Newton.
Kossuth Mutual Insurance Association, Algona.
Lee County Mutual Insurance Association, West Point.
Lincoln Mutual Insurance Association, Johnson County, Lone Tree.
Marion County Mutual Insurance Association, Knoxville.
Members Mutual Insurance Assocation of Clay County, Spencer.
Mill Owners Mutual Fire Insurance Co., Des Moines.
Mount Carmel Mutual Insurance Association, Carroll County, Carroll.
Mutual Fire and Automobile Insurance Co., Cedar Rapids.
Mutual Fire and Storm Insurance Co., Burlington.
Northwestern Mutual Insurance Association, Iowa City.
Patrons Mutual Insurance Association, Iowa County, Williamsburg.
Pioneer Mutual Insurance Association, Red Oak.
Plymouth Farmers Mutual Insurance Association, Le Mars.
Pocahontas Mutual Insurance Association, Laurens.
Polk County Farmers Mutual Fire Insurance Association, Des Moines.
Pottawattamie Mutual Insurance Association, Council Bluffs.
Poweshiek Mutual Insurance Association, Grinnell.
Readlyn Mutual Insurance Association, Bremer County, Readlyn.
St. Ansgar Mutual Insurance Association, St. Ansgar.
Scandinavian Mutual Insurance Association of Webster and Adjoining Counties, Dayton.
Shelby County Farmers Mutual Insurance Association, Harlan.
Square Deal Insurance Co., Des Moines.
Swedish Mutual Insurance Association, Madrid.
The Tama County Mutual Insurance Association of Tama County, Traer.
Town Mutual Dwelling Insurance Co., Des Moines.
Victoria Farmers Mutual Insurance Association, Massena.
Wayne County Mutual Insurance Association, Corydon.
Western Cherokee Mutual Insurance Association, Marcus.
Western Mutual Insurance Co., Des Moines.
The White Pigeon Mutual Insurance Association, Wilton Junction.
Worth County Mutual Insurance Association, Northwood.

KANSAS

The Bremen Farmers Mutual Insurance Co., Bremen.
Ford County Farmers Mutual Insurance Co., Offerle.
Kansas Mutual Insurance Co., Topeka.
Midland Mutual Fire Insurance Co., Newton.

KENTUCKY

Covington Mutual Insurance Co., Covington.
Farmers Cooperative Insurance Co., Vanceburg.
Farmers Insurance Association, Inc., of Daviess County, Owensboro.
Farmer's Mutual Fire Insurance Co. of Boone County, Burlington.
Farmers Mutual Insurance Co. of Mason County, Maysville.
Hurst Home Insurance Co., Lexington.
Kenton County Assessment Fire Insurance Co., Independence.
Kentucky Growers Insurance Co., Lexington.
Planters' Insurance Co., Inc., Bowling Green.

MAINE

Aroostook County Patrons Mutual Fire Insurance Co., Presque Isle.
Mutual Fire Insurance Co., Saco.
Oxford County Patrons of Husbandry Mutual Fire Insurance Co., South Paris.
United Mutual Fire Insurance Co., Presque Isle.
York Mutual Insurance Co. of Maine, West Buxton.

MARYLAND

The Farmers' and Mechanics' Mutual Insurance Association of Cecil County, Inc., North East.
The Mutual Fire Insurance Co. of Kent County, Maryland, Chestertown.
Mutual Fire Insurance Co. of Montgomery County, Sandy Spring.
The Mutual Insurance Co. of Frederick County, Frederick.
The Olympic Insurance Co. of America, Baltimore.
Taneytown Mutual Fire Insurance Co., Carroll County, Taneytown.

MASSACHUSETTS

Abington Mutual Fire Insurance Co., Abington.
Allied American Mutual Fire Insurance So., Wakefield.
American Mutual Liability Insurance Co., Wakefield.
Associated Merchants Mutual Insurance Co., Boston.
Attleboro Mutual Fire Insurance Co., Attleboro.
Berkshire Mutual Insurance Co., Pittsfield.
Cambridge Mutual Fire Insurance Co., Andover.
Dorchester Mutual Fire Insurance Co., Boston.
Fitchburg Mutual Fire Insurance Co., Fitchburg.
Hingham Mutual Fire Insurance Co., Hingham.
Holyoke Mutual Fire Insurance Co., Salem.
Liberty Mutual Fire Insurance Co., Boston.
Liberty Mutual Insurance Co., Boston.
Lynn Mutual Fire Insurance Co., Concord.
Merrimack Mutual Fire Insurance Co., Andover.
Middlesex Mutual Fire Insurance Co., Concord.
Mutual Boiler & Machinery Insurance Co., Waltham.
Mutual Fire Insurance Association of New England, Boston.
Quincy Mutual Fire Insurance Co., Quincy.
Traders & Mechanics Insurance Co., Lowell.
Worcester Mutual Fire Insurance Co., Worcester.

MICHIGAN

American Fellowship Mutual Insurance Co., Detroit.
Auto-Owners (Mutual) Insurance Co., Lansing.
Century Mutual Insurance Co., Charlotte.
Citizens Mutual Automobile Insurance Co., Howell.
Dowagiac Mutual Insurance Co., Dowagiac.
Farm Bureau Mutual Insurance Co. of Michigan, Lansing.
Farmers' & Merchants' Mutual Fire Insurance Co., Calument.
Farmers' Mutual Fire Insurance Co. of Branch County, Coldwater.
Farmers Mutual Fire Insurance Co. of Clinton & Gratiot Counties, St. Johns.
Farmers Mutual Fire Insurance Co. of Ingham County, Mason.
Farmers Mutual Fire Insurance Co. of Oskar.
Farmers' Mutual Fire Insurance Co. of St. Joseph County, Centerville.
The Finnish Mutual Fire Insurance Co., Hancock.
Frankenmuth Mutual Insurance Co., Frankenmuth.
Fremont Mutual Fire Insurance Co., Fremont.
Grange Mutual Fire Insurance Co., Cadillac.
Hastings Mutual Insurance Co., Hastings.
Italian Mutual Fire Insurance Co., Laurium.
Lincoln Mutual Casualty Co., Detroit.
Michigan Millers Mutual Insurance Co., Lansing.
Michigan Mutual Auto Insurance Co., Traverse City.
Michigan Mutual Hail Insurance Co., Lansing.
Michigan Mutual Liability Co., Detroit.
Northern Mutual Fire Insurance Co. of Ishpeming, Ishpeming.
Patron's Mutual Insurance Co., Adrian.
People's Mutual Insurance Co., Ionia.
Pioneer Mutual Insurance Co., Lansing.
Sanilac Mutual Insurance Co., Carsonville.
Scandinavian Farmers Mutual Fire Insurance Co. of Montcalm and Kent Counties, Gowen.
Southeastern Mutual Fire Insurance Co., Detroit.

Southern Michigan Mutual Insurance Co., Marshall.
State Mutual Cyclone Insurance Co., Lapeer.
State Mutual Insurance Co., Flint.
Upper Peninsula Farmers Mutual Fire Insurance Co., Rock.
West Michigan Mutual Insurance Co., Grand Rapids.
Wolverine Mutual Fire Insurance Co., Dowagiac.
Woodland Mutual Fire Insurance Co., Woodland.

MINNESOTA

Acton & Gennessee Mutual Fire Insurance Co., Grove City.
Austin Mutual Insurance Co., Minneapolis.
Barber Farmers Mutual Fire Insurance Co., Easton.
Beaver Creek Mutual Insurance Co., Luverne.
Bird Island Mutual Fire Insurance Co., Bird Island.
Bloomfield Township Mutual Fire Insurance Co., Spring Valley.
Blue Earth Farmers Mutual Fire Insurance Co., Blue Earth.
Border Farmers Mutual Fire Insurance Co., Pitt.
Bray Mutual Fire Insurance Co., Red Lake Falls.
Carlton County Farmers Mutual Fire Insurance Co., Carlton.
Citizens Fund Mutual Casualty Co., Red Wing.
Citizens Fund Mutual Fire Insurance Co., Red Wing.
Claremont Farmers Mutual Fire Insurance Co., Dodge Center.
Cottage Grove Farmers Mutual Fire Insurance Co., Newport.
Delafield Fire Insurance Co., Kinbrae.
Delaware Farmers Mutual Fire Insurance Co., Herman.
Des Moines German Mutual Fire & Lightning Insurance Co., Jackson.
Dovre & Mamre Insurance Co., Willmar.
Elmdale Farmers Mutual Insurance Co., Inc., Swanville.
Esko Mutual Fire Insurance Co., Esko.
Farm Mutual Re-Insurance Association of Minnesota, Esko.
Farmers Home Mutual Insurance Co., Minneapolis.
Farmers Mutual Fire Insurance Co. of Bath, Geneva.
Federated Mutual Implement & Hardware Insurance Co., Owatonna.
Flora Mutual Fire Insurance Co., Danube.
Glendorado Farmers Mutual Fire Insurance Co., Princeton.
Gordon Mutual Fire Insurance Co., Osakis.
Graham Mutual Fire Insurance Co., St. Cloud.
Hay Creek Mutual Fire Insurance Co., Red Wing.
Holmes City Farmers Mutual Insurance Co., Holmes City.
Hope Mutual Fire Insurance Co., Tyler.
Inver Grove Mutual Fire Insurance Co., Rosemont.
Itasca Mutual Insurance Co., Bigfork.
Lac qui Parle Mutual Insurance Co., Dawson.
Lake Region Mutual Insurance Co., New York Mills.
Louisville Mutual Fire Insurance Co., Jordan.
Marshall County Mutual Insurance Co., Newfolden.
Middleville Mutual Fire Insurance Co., Howard Lake.
Minnesota Farmers Mutual Insurance Co., Minneapolis.
Minnesota Mutual Fire & Casualty Insurance Co., Minneapolis.
Minnesota Lake Farmers Mutual Insurance Co., Minnesota Lake.
Moe & Urness Mutual Fire Insurance Co., Brandon.
Mound Prairie Mutual Insurance Co., Houston.
Murray County Mutual Insurance Co., Slayton.
Mutual Service Casualty Insurance Co., St. Paul.
National Mutual Dwelling House Fire Insurance Co., Red Wing.
Nessel Farmers Mutual Fire Insurance Co., Pine City.
New Prague Mutual Insurance Co., New Prague.
New Sweden Mutual Fire Insurance Co., Nicollet.
North Shore Mutual Fire Insurance Co., Two Harbors, Minn.
North Star Farmers Mutual Insurance Co., Cottonwood.
Norwegian Mutual Fire Insurance Co., Cottonwood.
Oscar Farmers Mutual Town Insurance Co., Fergus Falls.
Palo Farmers Mutual Fire Insurance Association, Aurora.
Patron's Co-operative Fire Insurance Co., Robbinsdale.
Preble Farmers Mutual Fire Insurance Co., Lanesboro.
Redwood County Farmers Mutual Insurance Co., Lamberton.

Rollingstone Mutual Farmers Fire Insurance Co., Lewiston.
Rose Dell Mutual Fire Insurance Co., Luverne.
St. Leo Farmers Mutual Fire Insurance Co., Taunton.
St. Paul Mutual Insurance Co., St. Paul.
Security Mutual Fire Insurance Co., Chatfield.
Shelby Farmers Mutual Insurance Co., Amboy.
Spring Garden Leon Mutual Fire Insurance Co., Cannon Falls.
Spring Vale Mutual Fire Insurance Co., Dalbo.
Stark Farmers Mutual Fire Insurance Co., Sleepy Eye.
Sumter Mutual Fire Insurance Co., Brownton.
Sversrup Mutual Insurance Co., Underwood.
Sweet Township Mutual Fire Insurance Co., Pipestone.
Tri-State Mutual Insurance Co., Luverne.
Unity Mutual Insurance Co., Howard Lake.
Vernon Edda Mutual Fire Insurance Co., Hayfield.
Wanamingo, Cherry Grove & Minneola Mutual Fire Insurance Co., Goodhue.
Westbrook Mutual Insurance Co., Storden.
White Bear Lake Insurance Co., Starbuck.
Willmar Farmers Mutual Insurance Co., Willmar.
Wilmington Mutual Insurance Co., Spring Grove.
Wilmot Mutual Fire Insurance Co., Lismore.
Young America Mutual Fire Insurance Co., Norwood.

MISSOURI

Adair County Farmers Mutual Insurance Co., Kirksville.
Arnsburg Farmers Fire & Lightning Insurance Co., Uniontown.
Cedar Fork Mutual Aid Society, Gerald.
Central Mutual Casualty Co., Kansas City.
Citizens Mutual Fire Insurance Co., Cape Girardeau County, Daisy.
Clark's Fork Farmers' Mutual Insurance Co., Cooper County, Bunceton.
Colfax Farmers Mutual Insurance Co. of Tarkio, Tarkio.
Concordia Farmers Mutual Insurance Co., Concordia.
Crawford County Mutual Fire & Lightning Insurance Co., Leasburg.
Dallas County Mutual Insurance Co., Urbana.
Farmers Home Insurance Co. of Ray County, Richmond.
The Farmers' & Laborers' Co-Operative Insurance Association of Monroe County, Paris.
Farmers Mutual Insurance Co., Atchinson County, Rockport.
Farmers Mutual Fire Insurance Co. of Barton County, Liberal.
Farmers Mutual Fire Insurance Co. of Chamois, Osage County, Chamois.
Farmers Mutual Fire Insurance Co. of Chariton County, Mendon.
Farmers Mutual Fire Insurance Co. of Clark County, Kahoka.
Farmers Mutual Insurance Co. of Clay County, Liberty.
Farmers Mutual Fire Insurance Co. of Clinton County, Missouri, Plattsburg.
Farmers Mutual Fire Insurance Co. of Dade County, Mo., Lockwood.
Farmers Mutual Fire Insurance Co. of DeKalb County, Maysville.
The Farmers Mutual Fire Insurance Co. of Harrison County, Bethany.
Farmers' Mutual Fire & Lightning Insurance Co. of Henry County, Clinton.
Farmers Mutual Insurance Co. of Hickory County, Mo., Wheatland.
Farmers Mutual Fire Insurance Co. of Jefferson & Franklin Counties, Dittmer.
Farmers Mutual Insurance Co. of Lawrence County, Freistatt.
Farmers Mutual Insurance Co. of Linn County, Meadsville.
Farmers Mutual Insurance Co. of Livingston County, Chillicothe.
Farmers Mutual Insurance Co. of Macon, Mo., Macon.
Farmer's Mutual Insurance Co. of Marion County, Palmyra.
Farmers Mutual Fire Insurance Co. of Nixa, Christian County, Nixa.
Farmers Mutual Fire Insurance Co. of Pettis County, Sedalia.
Farmers Mutual Fire & Lightning Insurance Association of Phelps County, Vida.
The Farmers Mutual Fire Insurance Co. of Platte County, Platte City.
Farmers Mutual Fire & Lightning Insurance Co. of Polk County, Bolivar.
Farmers Mutual Fire Insurance Co. of St. Johns, Washington.
Farmers Mutual Fire Insurance Co. of St. Louis, Clayton.
Farmers Mutual Fire Insurance Co. of Scotland County, Memphis.
Farmers Mutual Fire Insurance Co. of Shelby County, Shelbina.

Farmers Mutual Insurance Co. of Sullivan & Adjoining Counties, Milan.
Farmers Mutual Fire & Lightning Insurance Co. of Vernon County, Nevada.
The Farmer's Mutual Hail Insurance Co. of Columbia.
Farmers Mutual Re-Insurance Co. of Missouri, Liberty.
Farmers Mutual Windstorm Insurance Co., Columbia.
Farmers-Planters Mutual Hail Insurance Co., Cape Girardeau.
Forest Green Farmers Mutual Insurance Co., Forest Green.
Grange Mutual Insurance Co. of Lewis County, Maywood.
Hazel Dell Farmers Mutual Fire & Lightning Insurance Co. of Moniteau County, Latham.
Home Mutual Insurance Co., Columbia, Mo.
Home Mutual Insurance Co. of Newton & McDonald Counties, Meosho.
Johnson County Mutual Insurance Co., Warrensburg.
Knox County Farmers Mutual Insurance Association, Edina.
Mercer County Mutual Fire Insurance Co., Princeton.
M.F.A. Mutual Insurance Co., Columbia.
The Mutual Insurance Association of Laclede County, Lebanon.
Patrons & Farmers Mutual Fire Insurance Co. of Cass County, Harrisonville.
Patrons Mutual Insurance Co. of Lafayette, Bates City.
Pike County Farmers Mutual Fire Insurance Co., Bowling Green.
Ralls County Farmers Mutual Fire Insurance Co., Hannibal.
Scott County Farmers Mutual Aid Society, Illmo.
Southeast Missouri Mutual Fire Insurance Co., Inc., Dexter.
State Farmers Mutual Tornado Insurance Co., Cameron.
Texas County Farmers Mutual Insurance Co., Licking.
Tipton Mutual Fire Insurance Co., Moniteau County, Tipton.
Traders Mutual Fire Insurance Co., Kansas City.
Union Town Mutual Fire Insurance Co., Union.

MONTANA

Tri-County Farmers Fire Insurance Co., Malta.

NEBRASKA

Battle Creek Mutual Insurance Co., Battle Creek.
Capital Mutual Insurance Co., Lincoln.
Farm Bureau Insurance Co., of Nebraska, Lincoln.
Farmers Mutual Insurance Co., of Nebraska, Lincoln.
Farmers Union Cooperative Insurance Co., Omaha.
The Gage County Insurance Co., Blue Springs.
German Mutual Insurance Co., of Dodge County, Scribner.
German Mutual Insurance Association of Nebraska, Auburn.
Mid-Continent Fire & Hail Insurance Co., Lincoln.
Nebraska Hardware Mutual Insurance Co., Lincoln.
Roman Catholic Farmers Mutual Fire Insurance Co., Petersburg.
Standard Reliance Insurance Co., Lincoln.
Union Insurance Co., Lincoln.
Western Plains Insurance Co., (Fort Dodge, Iowa, executive office), Lincoln.

NEW HAMPSHIRE

Orange Mutual Insurance Co., Rochester.

NEW JERSEY

Mercer Mutual Insurance Co., Pennington.

NEW MEXICO

Mountain States Mutual Casualty Co., Albuquerque.

NEW YORK

Allegany County Farmers Co-op Fire Insurance Co., Friendship.
American Co-operative Fire Insurance Co., of Sullivan & Adjacent Counties, Woodridge.
Argyle Co-op Fire Insurance Co., of the Town of Argyle, Argyle.
Bethlehem Mutual Insurance Association, Feura Bush.

Bovina Co-operative Fire Insurance Co., Bovina Center.
Broome County Co-operative Fire Insurance Co., Windsor.
Callicoon Agricultural Mutual Fire Relief Association of Sullivan County, Jeffersonville.
Capital District Grange Co-operative Fire Insurance Co., Greenville.
Cayuga County Farmers Insurance Co., Auburn.
Cayuga County Patrons "Fire" Relief Association, Popular Ridge.
Chautauqua County Patrons Fire Relief Association, Jamestown.
Chenango Co-operative Insurance Co., Norwich.
Clinton County Fire Relief Association, Wadhams.
Consolidated Mutual Insurance Co., Brooklyn.
Co-operative Fire Insurance Co., of Sullivan & Adjoining Counties, Woodridge.
Co-operative Windstorm Insurance Co., of New York, Greenville.
Cortland County Patrons' Fire Relief Association, Blodgett Mills.
Cosmopolitan Mutual Insurance Co., New York.
Dryden & Groton Co-op. Fire Insurance Co., Freeville.
Dutchess & Columbia Patrons' Fire Relief Association, Pine Plains.
Empire Mutual Insurance Co., New York.
Exchange Mutual Insurance Co., Buffalo.
Farm Family Mutual Insurance Co., Delmar.
Farmers Fire Insurance Association of the Towns of Greenville, Durham, Westerlo & Rensselaerville, Oak Hill.
Farmers Fire & Lightning Insurance Co., of Oneida County, Westernville.
Farmers Mutual Indemnity Association of Cayuga County, Moravia.
Farmers Mutual Insurance Co. of Orleans & Niagara Counties, Lockport.
Farmers' Reliance Mutual Insurance Co., Montour Falls.
Fifth Co-operative Fire Insurance Co., of Sullivan & Adjoining Counties, Woodridge.
The Fire Relief Association of Wayne County, Williamson.
Greater New York Mutual Insurance Co., New York.
Guilderland Mutual Insurance Co., Greenville.
Home Mutual Insurance Co., of Binghamton, Binghamton.
Interboro Mutual Indemnity Insurance Company, New York.
Jamestown Mutual Insurance Co., Jamestown.
Madison-Onondaga Mutual Fire Insurance Co., Chittenango.
Merchants Mutual Insurance Co., Buffalo.
Monroe County Patrons' Fire Relief Association, Rochester.
Mountain Co-operative Fire Insurance Co. of Sullivan & Adjoining Counties, Woodbridge.
Mutual Insurance Association of Nassau, Schodack & Chatham, North Chatham.
North Country Co-operative Insurance Co., Watertown.
The Olive Co-op. Fire Insurance Association, Kingston.
Onandaga County Patrons Fire Relief Association, Manlius.
Ontario County Patrons' Fire Relief Association, Phelps.
Orleans County Farmers' Mutual Insurance Co., Albion.
Otsego County Patrons Co-op. Fire Relief Association, Schenevus.
Patrons Co-op. Fire Relief Association of Steuben & Livingston Counties, Wayland.
Patrons Fire Relief Association of Seneca County, Interlaken.
Patrons of Husbandry Co-op. Fire Relief Association of the County of Herkimer, Herkimer.
The Pioneer Co-operative Fire Insurance Co., Greenville.
Preferred Mutual Insurance Co., New Berlin.
Public Service Mutual Insurance Co., New York City.
Salem Mutual Town Fire Insurance Co., Salem.
Sauquoit Valley Farmers Association, Sauquoit.
Schoharie & Schenectady Counties Farmers Mutual Fire Insurance Association, Esperance.
Security Mutual Insurance Co. of New York, New York.
Springfield Cooperative Insurance Co., East Springfield.
Surety Co-op Fire Insurance Co., Hornell.
The Third Cooperative Fire Insurance Co. of Sullivan and Adjoining Counties, Woodridge.
Tompkins Cooperative Fire Insurance Co., Ithaca.
Tompkins, Schuyler & Tioga Counties Patron's Fire Relief Association, Trumansburg.

Utica Mutual Insurance Co., Utica.
Walton Co-operative Fire Insurance Co., Walton.
Utilities Mutual Insurance Co., New York.
Walton Co-operative Fire Insurance Co., Walton.
Westchester & Putnam Patrons Fire Relief Association, Valls Gate.
Westmoreland Cooperative Insurance Association, Rome.

NORTH CAROLINA

Hardware Mutual Fire Insurance Co. of the Carolinas, Charlotte.

NORTH DAKOTA

The Grant Farmers Mutual Fire & Lightning Insurance Co., Minot.
Kenmare Farmers Mutual Fire & Lightning Insurance Co., Kenmare.

OHIO

The Buckeye State Mutual Insurance Association, Covington.
The Celina Mutual Insurance Co., Celina.
Central Mutual Insurance Co., Van Wert.
Erie County Farmers Insurance Co., Sandusky.
Farmers Mutual Aid Association of Van Wert County, Van Wert.
Farmers' Mutual Fire Insurance Co. of Darke County, Greenville.
Farmers Mutual Insurance Association of Seneca County, Tiffin.
The Henry County Farmers' Mutual Insurance Co., Napoleon.
The Huron County Farmers Insurance Co., North Fairfield.
Lightning Rod Mutual Fire Protective Association, Wooster.
The Lumbermens Mutual Insurance Co., Mansfield.
Motorists Mutual Insurance Co., Columbus.
The National Mutual Insurance Co., Celina.
Nationwide Mutual Fire Insurance Co., Columbus.
Nationwide Mutual Insurance Co., Columbus.
The Norton Mutual Fire Association, Barberton.
The Ohio Hardware Mutual Insurance Co., Coshocton.
The Ohio Mutual Windstorm Insurance Association, Bucyrus.
The Ohio State Grange Mutual Insurance Association, Newark.
The Patrons Mutual Insurance Association of Ohio, Bellefontaine.
Shelby County Farmers Mutual Insurance Association, Anna.
Washington Township Mutual Fire & Lightning Insurance Association, Lakeville.

OKLAHOMA

Union Mutual Insurance Co., Oklahoma City.

OREGON

Butteville Insurance Co., Woodburn.
Orange Mutual Fire Insurance Co. of Oregon, Portland.
The Hop Growers Fire Relief Association of Butteville, Oreg., Woodburn.
Oregon Mutual Insurance Co., McMinnville.
Pioneer Mutual Insurance Co., Hillsboro.
Sublimity Fire Insurance Co., Stayton.

PENNSYLVANIA

Allen Mutual Insurance Co., Allentown.
The Angelica Mutual Fire Insurance Co. of Berks County, Mohnton.
Annville Mutual Insurance Co., Annville.
Briar Creek Farmers Mutual Insurance Co., Orangeville.
Brush Creek Mutual Fire Association, Beaver Falls.
The Bucks County Contributionship, Morrisville.
Cambria County Mutual Fire Insurance Co., Patrons of Husbandry, Ebensburg.
Carpenter Mutual Insurance Co. of Curwensville, Pa., Curwensville.
Center Valley Mutual Fire Insurance Co., Vandergrift.
Chester County Mutual Insurance Co., Coatesville.
Clarion County Mutual Fire Insurance Co., Clarion.
Commercial Mutual Insurance Co., Lebanon.

Conemaugh Valley Mutual Fire Insurance Co., Johnstown.
Coolspring Valley Mutual Fire Insurance Co., Mercer.
Countrymen's Mutual Fire Insurance Co., Lebanon.
Donegal Mutual Insurance Co., Marietta.
Elk County Mutual Fire Insurance Co., Patrons of Husbandry, Ridgway.
Empire Mutual Insurance Co., Philadelphia.
Erie County Mutual Insurance Co., Erie.
Farmers Alliance & Industrial Union, Shinglehouse.
Farmers American Mutual Fire Insurance Co. of Bucks County, Dublin.
Farmers & Mechanics Home Mutual Fire Insurance Co. of Sullivan County, Forksville.
The Farmers Mutual Insurance Co. of Berks County, Robesonia.
Farmers Mutual Fire Insurance Co., Centre County, Spring Mills.
Farmers Mutual Fire Insurance Co. of Hannahstown, Marwood.
Farmers' Mutual Insurance Co. in the County of Lancaster, Elizabethtown.
Farmers Mutual Fire Insurance Co. of Marble, Pa., Marble.
Farmers Mutual Fire Insurance Co. of Schuylkill County, Orwigsburg.
Farmers Mutual Insurance Co. of Tuscarora, Wyalusing.
The Frankford Union Mutual Fire Insurance Co., Philadelphia.
Fulton County Mutual Fire Insurance Co., Needmore.
Greene County Farmers Mutual Insurance Co., Wind Ridge.
Harborcreek Mutual Fire Insurance Co. of Erie, Erie.
Harleysville Mutual Casualty Co., Harleysville.
Harleysville Mutual Insurance Co., Harleysville.
Juniata Farmers Mutual Fire Insurance Co., McAlisterville.
Lancaster County Mutual Insurance Co., Lancaster.
Limestone Mutual Fire Insurance Co., New Bethlehem.
Lititz Mutual Insurance Co., Lititz.
Lykens Valley Mutual Fire Insurance Co., Elizabethville.
Mendon Orange Mutual Fire Insurance Co., Smithton.
Merchants and Business Men's Mutual Insurance Co., Harrisburg.
Millville Mutual Insurance Co., Millville.
Montour Mutual Insurance Co., Danville.
Mt. Jackson Mutual Fire Insurance Co., Wampum.
Mount Joy Mutual Insurance Co., Mount Joy.
Mutual Fire Insurance Co. of South Bend Township, Apollo.
The Mutual Fire, Marine & Inland Insurance Co., Philadelphia.
National Mutual Assurance Co., Allentown.
Neffsville Mutual Fire Insurance Co., Lititz.
Nescopeck Mutual Fire Insurance Co., Nescopeck.
Northampton Mutual Insurance Co., Easton.
Northern Mutual Insurance Co. of Lancaster County, Ephrata.
Old Guard Mutual Insurance Co., Lancaster.
Paradise Mutual Insurance Co., Hanover.
Penn Charter Mutual Insurance Co., Lititz.
Pennsylvania Association of Mutual Insurance Companies, Lancaster
Pennsylvania Lumbermens Mutual Insurance Co., Philadelphia.
Pomona No. 8 Mutual Fire Insurance Co., West Chester.
Pymatuning Mutual Fire Insurance Co., Mercer.
Saucon Mutual Insurance Co., Bethlehem.
Southern Mutual Insurance Co., Quarryville.
Southwestern Mutual Fire Association, Uniontown.
Tulpehocken Mutual Insurance Co., Myerstown.
Union Mutual Insurance Co. of Westmoreland County, Greensburg.
Wayne County Farmers Mutual Insurance Co., Honesdale.
Western Pennsylvania Mutual Fire Insurance Co., New Castle.
Windsor Mutual Insurance Co., Hamburg.

RHODE ISLAND

Automobile Mutual Insurance Co. of America, Providence.
Factory Mutual Liability Insurance Co. of America, Providence.
Pawtucket Mutual Insurance Co., Pawtucket.
The Providence Mutual Fire Insurance Co., Providence.
Union Mutual Fire Insurance Co. of Providence, Providence.

SOUTH CAROLINA

The American Mutual Fire Insurance Co., Charleston.
Orange Mutual Fire Insurance Association of South Carolina, Inc., West Columbia.

SOUTH DAKOTA

Farmers Mutual Fire & Lightning Insurance Co. of Hanson County, Alexandria.
Farmers Mutual Insurance Co. of Volga, Brookings County, Volga.
Farmers Mutual Tornado-Cyclone Insurance Co. of Union & Clay Counties, Elk Point.

TENNESSEE

Farmers Mutual Fire Insurance Co. of Knox County, Knoxville.

TEXAS

Collin County Farmers' Mutual Insurance Co., McKinney.
Farmers Mutual Fire Insurance Association of Comal County, New Braunfels.
Germania Mutual Aid Association, Brenham.
Mutual Aid Fire Insurance Association of Hays, Caldwell and Adjoining Counties, Kyle.
The Old American County Mutual Fire Insurance Co., Dallas.
Slavonic Mutual Fire Insurance Association, East Bernard.
Svea Mutual Fire Insurance Association, Inc., Taylor.
Texas Employers' Insurance Association, Dallas.

UTAH

Bear River Mutual Insurance Co., Salt Lake City.

VERMONT

Granite Mutual Insurance Co., Barre.
Union Mutual Fire Insurance Co., Montpelier.
Vermont Mutual Fire Insurance Co., Montpelier.

VIRGINIA

Dan River Farmers Mutual Fire Insurance Co., Danville.
East Augusta Mutual Fire Insurance Co., Inc., Staunton.
Henrico Mutual Fire Insurance Co., Richmond.
The Northern Neck Mutual Fire Association of Virginia, Irvington.
Shenandoah Mutual Fire Insurance Co., Woodstock.
West Rockingham Mutual Fire Insurance Co., Harrisonburg.

WASHINGTON

Farmers' Mutual Insurance Co., Enumclaw.
Northwestern Mutual Insurance Co., Seattle.
Public Employers Mutual Casualty Co., Seattle.

WEST VIRGINIA

The Farmers Home Fire Insurance Co. of West Virginia, Lewisburg.
Farmers Union Association & Fire Insurance Co. of Preston County, Bruceton Mills.
Grange Mutual Fire Insurance Co. of West Virginia, Philippi.
Inland Mutual Insurance Co., Huntington.
Municipal Mutual Insurance Co., Wellsburg.
Mutual Fire Insurance Co. of West Virginia, Clarksburg.
Pan Handle Farmers Mutual Insurance Co., West Alexander.
Safe Insurance Co., Harrisville.
West Virginia Insurance Co., Harrisville.

WISCONSIN

Alden and Black Brook Mutual Fire Insurance Co., Amery.
Arkdale Mutual Fire Insurance Co., Friendship.
Aurora Mutual Fire Insurance Co., Berlin.
Badger Mutual Insurance Co., Milwaukee.
Calumet Mutual Insurance Co., New Holstein.
Central Mutual Hail & Cyclone Insurance Co., Hortonville.
Church Mutual Insurance Co., Merrill.
Citizens Mutual Insurance Co., Janesville.
Clyman Town Mutual Fire Insurance Co., Juneau.
Cream City Mutual Insurance Co., Milwaukee.
Crystal Lake Farmer's Mutual Fire Insurance Co., Neshkoro.
Eagle Point Mutual Fire Insurance Co., Chippewa Falls.
Employers Mutual Fire Insurance Co., Wausau.
Employers Mutual Liability Insurance Co. of Wisconsin, Wausau.
Farmers Mutual Automobile Insurance Co., Madison.
Farmers Mutual Insurance Co. of Wisconsin, Madison.
Furniture Mutual Insurance Co., Milwaukee.
Germantown Mutual Insurance Co., Germantown.
Hardware Dealers Mutual Fire Insurance Co., Stevens Point.
Hardware Dealers Mutual Casualty Co., Stevens Point.
Hartland Cicero Mutual Insurance Co., Seymour.
Herman Mutual Insurance Co., Iron Ridge.
Hull Town Mutual Insurance Co., Colby.
Integrity Mutual Insurance Co., Appleton.
Jewelers Mutual Insurance Co., Neenah.
Kewaskum Mutual Insurance Co., Kewaskum.
Lima-Johnstown Town Mutual Fire Insurance Co., Whitewater.
Lynn Mutual Insurance Co., Neillsville.
Manitowoc County Mutual Fire Insurance Co., Manitowoc.
Manitowoc Mutual Fire Insurance Co., Manitowoc.
Marcellon Town Mutual Fire Insurance Co., Portage.
Market Men's Mutual Insurance Co., Milwaukee.
Martell Mutual Town Fire Insurance Co., Baldwin.
McMillan Grange Mutual Fire Insurance Co., Marshfield.
Medina Mutual Insurance Co., Deerfield.
Middleton Insurance Co., Middleton.
Mutual Fire Insurance Co. of Bloomington, Wis., Bloomington.
Newark Mutual Fire Insurance Co., Beloit.
New Hope Mutual Fire Insurance Co., Amherst Junction.
Oakfield Town Mutual Fire Insurance Co., Oakfield.
Paris Mutual Fire Insurance Co., Union Grove.
Raymond Mutual Fire Insurance Co., Franksville.
Rosendale Mutual Insurance Co., Rosendale.
Salem Mutual Town Insurance Co., Salem.
Trempealeau County Mutual Fire Insurance Co., Galesville.
Union Mutual Fire Insurance Co., Evansville.
Washington Town Insurance Co., Washington Island.
Waupun Farmers Mutual Fire Insurance Co., Waupun.
West Bend Mutual Fire Insurance Co., West Bend.
Wisconsin Mutual Insurance Co., Madison.

(By direction of the chairman, the following is made a part of the record:)

THE PIONEER COOPERATIVE FIRE INSURANCE CO.,
Greenville, N.Y., March 26, 1962.

Re mutual insurance company tax bill, H.R. 10650.

Hon. HARRY FLOOD BYRD,
Senate Finance Committee, Washington, D.C.

DEAR SIR: Our company believes that certain features of the mutual insurance company tax bill (H.R. 10650) in its present form are unfair and discriminatory.

Your support is solicited in making revisions in the bill as recommended by John J. Wicker, Jr., general counsel for the mutual insurance committee on Federal taxation.

We do not believe that you would wish to provide a bill which would be detrimental to the interests of your mutual policyholder constituents.

Very truly yours,

ROBERT C. O'KEEFE, *Secretary-Manager.*

TRADERS AND MECHANICS INSURANCE CO.,
Lowell, Mass., March 30, 1962.

Hon. HARRY FLOOD BYRD,
Senate Office Building, Washington, D.C.

DEAR SIR: I am writing to you about the new tax bill, H.R. 10650. If this bill becomes law, in its present form, it will be terribly unjust to mutual fire and casualty insurance companies as a whole; will cripple many mutuals, both large and small, by more than doubling their tax burden; and will be absolutely ruinous to some mutuals.

This new tax bill actually discriminates against mutuals and in favor of their stock competitors by prohibiting use of mutual investment income for policyholder dividends unless and until mutual loss protection funds are completely exhausted.

As it now stands, this bill would practically stifle necessary wholesome growth of many mutuals and would prevent large numbers of companies from accumulating and maintaining reasonably adequate surplus for protection of policyholders and the public.

This bill denies and refuses equally appropriate treatment to fire and casualty mutuals because it includes an arbitrary unjustifiable 5-year time limitation and an unnecessary and unreasonable ceiling on the mutuals' loss protection funds.

Unless these unjust and unreasonable discriminations are eliminated or corrected by Senate Finance Committee, this bill will do untold harm not only to mutuals but also to their policyholders.

The position of our mutuals will be formally presented during the Senate Finance Committee hearings by our general counsel, John J. Wicker, Jr.; and I would appreciate your giving serious consideration to his arguments against this proposed new tax.

Yours very truly,

H. K. BARTLETT, *President.*

Senator CURTIS. Yes.

I think that would be all the time I shall take.

In behalf of Chairman Byrd I want to thank Mr. Wicker and his associated witness.

The committee will stand adjourned until 2 o'clock.

(Whereupon, at 1 p.m., the committee stood in recess until 2 p.m., the same day.)

AFTERNOON SESSION

Senator LONG (presiding). The hearing will come to order.

Mr. Larry J. Desmond, speaking for the Reciprocal Inter-Insurers Federal Tax Committee.

Will you come forward?

STATEMENT OF LARRY J. DESMOND, REPRESENTING RECIPROCAL INTERINSURERS FEDERAL TAX COMMITTEE

Mr. DESMOND. I will not read my statement in the interest of time.

Senator LONG. I would prefer that your statement be printed in the record, if you think you can summarize it.

Mr. DESMOND. Yes, sir.

My name is L. J. Desmond. I am director of administrative services of the inter-insurance exchange of the Automobile Club of Southern California.

I appear here as the representative of the Reciprocal Inter-Insurers Federal Tax Committee, an association of reciprocal exchanges. A list of the membership appears in appendix I.

Time does not permit an exhaustive explanation of the nature of reciprocal insurance. Basically, however, it consists of two separate but interrelated elements. One is the group of individual subscribers insuring one another. This aggregation of subscribers is called the exchange. Reciprocal exchanges are not incorporated, having no capital stock or reserves standing in a corporate name. At the present time exchanges are subject to Federal income taxes on investment income.

The other element is the attorney-in-fact. Each subscriber executes an agreement, identical with that executed by every other subscriber, empowering the attorney-in-fact to assume on his behalf an underwriting liability on policies issued by the exchange covering the risks of the other subscribers. This power will generally include the administration of the affairs of the exchange. Attorneys-in-fact pay Federal income taxes on the same basis as any other taxpayer. The majority of attorneys-in-fact are incorporated and pay tax at the regular corporate rates.

I will be deviating somewhat now from the printed statement. Basically, the sponsors of H.R. 10650 claim the mutuals and reciprocals are escaping taxes, that taxes should be equalized between types of companies and that under the present tax system we have an unwarranted competitive advantage.

All of these claims are invalid as applied to reciprocals for the following reasons:

1. Reciprocals are not escaping tax. If you will refer to page 3, we will show you there the comparative Federal income taxes for stock, mutuals, and reciprocals, 1943 through 1959. First we have the stock; then the mutual; and then the reciprocal.

Under reciprocal we show the two entities, exchanges on the one hand and the attorneys in fact and then the total.

Dropping down to line 6, we show the income before Federal income taxes for the various types of insurance carriers, and we show the Federal income taxes paid during this time. The exchanges paid $6 million and the attorneys in fact on their share of the underwriting income paid $63 million for a total tax burden of $69 million.

On line 8, we show the percentage of taxes on income and in the case of stock companies, that was 29.7 percent. In the case of reciprocals, it was 26.2 percent.

On line 9, the percentage of taxes to premiums, in the case of stock companies, was 1.8 percent and in the case of reciprocals, it was 2.1 percent.

The second point is that H.R. 10650 will substantially increase the tax burden on reciprocals. We show that information on this table. Stated in terms of minimums and maximums, depending on the way the protection against loss account would work out, it would be a minimum tax, we estimate, of $99 million to a maximum of $103 million during this period of time. This would be somewhere between 30 and 39 percent of the net income as compared to only 29 percent for stock companies and 3.1 percent or 2.2 percent of premiums as compared to only 1.8 percent for stock companies.

Turning, then, to item No. 3, reciprocals have not enjoyed a competitive advantage. I merely wish to say that in 1942, when the present law was enacted, there were approximately 70 reciprocal exchanges and there are approximately that number today. At the time, we were writing about 3 percent of the industry volume and today we still only write about 3 percent of the total industry volume.

No. 4: Reciprocals have not accumulated an excessive amount of surplus. The table on the next page 5, shows the policyholder surplus in relation to premium volume for stock companies and for reciprocals. In 1960, the stock companies had a stock premium surplus ratio of 90 percent of premiums written and in the same year, reciprocals had a percentage of 50. This is a reduction of one-third since 1943.

In comparing surplus positions, it must be remembered that stock companies have access to the capital market if they need to add to their surplus, and reciprocals do not.

Senator LONG. Let me see if I understand what you are saying here, because if you have only one Senator to listen to you, at least you would expect that that one Senator would understand. You do not have to have many people on your side, provided he understands what you are talking about so he can explain it to the others.

It seems to me that this chart that you have prepared here is very meaningful, for it undertakes to show, on the item listed as No. 9, that the percentage of taxes to premiums showed, according to your calculations, that you are paying an amount of 2.1 percent compared to 1.8 percent for stock companies and 1.1 percent for mutual companies.

Mr. DESMOND. Yes, sir.

Senator LONG. If I understand correctly, the theory of this bill that has been sent to us by the House committee and the House—and, incidentally, I oftentimes say the "House committee" on these kinds of things, because it usually comes out under a rule where if a House Member does not like certain parts of it, he cannot offer an amendment to do something about it. He is hogtied. He has to say yes or no. He cannot say maybe I like this part or that part.

We Senators can offer as many amendments as we want to.

I notice that, if I understand correctly, the theory of increasing taxation on mutual companies is that they enjoy a favored status. What you are saying here is that, take any standard that you want to take and you are just not in the favored status to justify any additional taxation based on that theory?

Mr. DESMOND. Yes, sir; that is what we feel.

Senator LONG. It seems to me that one of the most meaningful comparisons you can get is percentage of taxes to premiums. That is the way most States tax insurance companies, is it not?

Mr. DESMOND. On the State level, yes; it is the percentage of premiums written.

Senator LONG. If you leave out the sociological argument about the desirability of one form of business over another and say that everybody is going to have to pay their share of taxes would that not be about the fairest way to look at one industry compared to another?

Mr. DESMOND. Yes, I think so. Even if you take another comparison such as percentage of taxes to net income, there is not a con-

siderable amount of difference at the same time and the effect of 10650 would be to increase that substantially, on either a net income basis or——

Senator LONG. I have been on this committee long enough to know that if you make a comparison on net income it can be very misleading, because we have ways of letting people add various amounts to their reserves and take accelerated depreciation if they are in the manufacturing business or percentage depreciation if they are in the oil and gas business. By the time we get through, that net income might not mean what it says.

But if you look at the overall percentage of tax you pay with regard to the amount of business you do, that is one standard that is hard to get away from. It is a very meaningful standard to estimate what your share of taxes should be. Are you telling me that you are paying almost twice as much as the mutuals and you are paying, oh, 20 percent more than the stock companies based on that standard of measurement?

Mr. DESMOND. Yes, sir; that is right.

Senator LONG. In support of that position, you point out that your segment of the industry has not expanded beyond merely holding its own on its share of the business?

Mr. DESMOND. That is right. There are really no tax advantages there that have permitted us to grow beyond the normal.

Senator LONG. How much would this increase your tax?

Mr. DESMOND. Again on this chart 3, we are estimating a minimum from $99 million to a maximum of $103 million, so we are talking about an approximately $34 million increase or roughly 50 percent increase in taxes.

Senator LONG. You say from 99 to 103. Are you talking about the minimum tax compared to what the maximum would be?

Mr. DESMOND. Yes.

Senator LONG. You could average that figure and say $101 million?

Mr. DESMOND. Yes, sir.

Senator LONG. And that would amount to an increase of 38 percent?

Mr. DESMOND. Yes.

Senator LONG. How much would it increase taxes on stock companies?

Mr. DESMOND This bill would not increase taxes on stock companies.

Senator LONG. That is my impression, that it does not change it for them.

Mr. DESMOND. It changes it for mutuals and reciprocals.

Senator LONG. I must say you have a convincing case. Please go ahead and proceed with your other information.

What would you recommend we do about this?

Mr. DESMOND. Well, we would prefer that you——

Senator LONG. Just vote the whole bill down. But what are the other possibilities?

Mr. DESMOND. We have some other possibilities which proceed along the lines of the mutual suggestions. That is, if this committee feels that something in the nature of this bill should be adopted, then we should remove the amount and time limitations on this protection against loss account to extend to some extent the benefits for the small

company and to eliminate the distinction between the deviating company and the dividend-paying company. There was considerable discussion about that this morning.

We have one further provision, which I may touch on now, which is at the end of our presentation on page 11.

We have a situation which does no apply to mutuals; it applies only to reciprocals; and I would like to read that if I may.

It states "Application of H.R. 10650 to Reciprocals With Corporate Attorneys in Fact." H.R. 10650 recognizes the difference between a reciprocal underwriter and a mutual insurance company, stating that the two differ in that the business of the reciprocal is conducted by two entities instead of one. The report points out that "regular" mutual insurance companies receive all of the premium income from insurance and, not only pay losses, but conduct directly the operation and management of the insurance activities, whereas the exchange portion of the reciprocal pays the insurance losses but the attorney-in-fact portion performs all or most of the insurance functions for a portion of the premium income of the exchange, such as writing premiums, selling premiums, and so forth.

The report continues that if the total income were earned by a mutual insurance company, which performs these operations itself, it would constitute underwriting income and would not be taxed under existing law.

The bill recognizes the reciprocals' unique form of operation and incorporates a provision permitting the reciprocal to combine the underwriting income of the attorney in fact with the exchange's underwriting income for offsetting underwriting losses in the exchange against the income of the attorney in fact to arrive at the total taxable income.

However, although recognizing this principle, H.R. 10650 does not permit the combining of the exchange's income and the attorney in fact income for the purpose of determining deferments into the protection-against-loss account or in computing the amount remaining in that account after the lapse of a 5-year period.

In this regard, only the exchange's income is allowed to be a basis for computation. The bill ignores the fact that although the same amount of premium may go into a mutual as goes into a reciprocal, the mutual may retain a greater portion of that premium than a reciprocal with a corporative attorney in fact. In other words, a mutual can avail itself of tax benefits due to deferral of a portion of its entire underwriting gain. This is a significant advantage from a competitive standpoint. In no event will the granting of the privilege of combining the exchange's income with the corporate attorney in fact income to determine the deferral portion of the underwriting gain result in such a reciprocal paying a lesser tax than a mutual. In fact, it will make the taxes on each type of insurer exactly the same.

The only way to have tax equality under H.R. 10650 is to amend it to treat the total income of the reciprocal, including its two parts, in the same manner as the total income of a mutual insurance carrier.

I think that can conclude my statement.

I will be glad to answer any questions. There are some parts I did not include.

(The complete prepared statement of Larry J. Desmond is as follows:)

STATEMENT OF L. J. DESMOND, LOS ANGELES, CALIF., REPRESENTING THE RECIPROCAL INTER-INSURERS FEDERAL TAX COMMITTEE

My name is L. J. Desmond. I am director of administrative services of the Inter-Insurance Exchange of the Automobile Club of Southern California.

I appear here as the representative of the Reciprocal Inter-Insurers Federal Tax Committee, and association of reciprocal exchanges. A list of the membership appears in appendix I.

NATURE OF RECIPROCAL INSURANCE

Time does not permit an exhaustive explanation of the nature of reciprocal insurance. Basically, however, it consists of two separate but interrelated elements. One is the group of individual subscribers insuring one another. This aggregation of subscribers is called the exchange. Reciprocal exchanges are not incorporated, having no capital stock or reserves standing in a corporate name. At the present time exchanges are subject to Federal income taxes on investment income.

The other element is the attorney in fact. Each subscriber executes an agreement, identical with that executed by every other subscriber, empowering the attorney in fact to assume on his behalf an underwriting liability on policies issued by the exchange covering the risks of the other subscribers. This power will generally include the administration of the affairs of the exchange. Attorneys in fact pay Federal income taxes on the same basis as any other taxpayer. The majority of attorneys in fact are incorporated and pay tax at the regular corporate rates.

H.R. 10650

H.R. 10650 would change the present method of taxation of mutual and reciprocal fire and casualty insurance companies and tax such companies on an entirely different basis. The sponsors claim these bills are needed because:

1. Mutuals and reciprocals are escaping tax now;
2. Taxes should be equalized between type of companies;
3. Under the present tax system, mutuals and reciprocals have an unwarranted competitive advantage.

All of these claims are invalid as applied to reciprocals for the following reasons:

1. *Reciprocals are not escaping tax.*—During the 17-year period, 1943–59, the reciprocals (the exchanges and their attorneys in fact) paid 2.1 percent of their premiums in Federal corporate income taxes as compared to 1.9 percent paid by stock compaı ies. These figures are set forth in the chart on page 3 which you may wish tc refer to. Line 1 shows the net premiums written by type of company. Lin(6 shows the income before Federal income taxes and line 7 shows the Federal income taxes. You will note that reciprocals paid a total of $69 million or 26 percent of net income (line 8) and 2.1 percent of net premiums (line 9) as compared with 29 percent of net income and 1.8 percent of net premiums for stock companies.

Comparative Federal income taxes, stock, mutual and reciprocal, 1943 through 1959

	Stock [1]	Mutual [1]	Reciprocal [2]		
			Exchanges	Attorneys in fact	Total
1. Net premiums written	$97,629,000,000	$30,246,000,000	$3,241,000,000		$3,241,000,000
2. Underwriting income	992,000,000	3,427,000,000	303,000,000		
3. Investment income and capital gains	5,574,000,000	1,100,000,000	75,000,000		
4. Income before policyholder dividends	6,566,000,000	4,527,000,000	378,000,000		
5. Policyholder dividends	557,000,000	3,210,000,000	237,000,000		
6. Income before Federal income taxes	6,009,000,000	1,317,000,000	141,000,000	$122,000,000	263,000,000
7. Federal income taxes	1,785,000,000	328,000,000	6,000,000	63,000,000	69,000,000
8. Percentage, taxes to income	29.7	24.9			26.2
9. Percentage, taxes to premiums	1.8	1.1			2.1
			Effect of H.R. 10650 (app. II)		
10. Minimum tax			$36,000,000	$63,000,000	$99,000,000
11. Percentage to income					37.6
12. Percentage to premiums					3.1
13. Maximum tax			40,000,000	63,000,000	$103,000,000
14. Percentage to income					39.2
15. Percentage to premiums					3.2

[1] Best's aggregates and averages, 1943–59.
[2] Private survey representing about 82 percent of the reciprocal premium volume.

2. *Under H.R. 10650 the reciprocals would have a considerably heavier tax burden than stock companies.*—Again, please refer to the chart on page 3. If the proposed Revenue Act had been in effect during the past 17-year period, reciprocals would have paid $99 million to $103 million in taxes, depending on the extent to which the loss protective fund would be absorbed by underwriting losses.

Reciprocals, then, would have paid in excess of 3 percent of premiums (lines 13 and 15) as compared to 1.9 percent for stock companies. And reciprocals would have paid 37 to 39 percent (lines 11 and 14) of their net income as compared to 29 percent for stock companies.

3. *Reciprocals have not enjoyed a competitive advantage.*—As far as reciprocals are concerned, the present tax law has not operated to create a competitive imbalance. In 1942, when the present law was enacted, there were approximately 70 reciprocal exchanges. There are approximately the same number today.

At that time reciprocals were writing 3 percent of the total premium volume of fire and casualty insurance. Today they still write only 3 percent of the total volume.

4. *Reciprocals have not accumulated an excessive amount of surplus.*—Reciprocals as a group have not unreasonably accumulated surplus, as may be evidenced by comparing the reciprocal record with accumulated surplus of stock companies.

	Premiums	Policyholders' surplus	Percent
Stock companies:			
1943	$2,090,000,000	$2,494,000,000	119.3
1960	10,528,000,000	9,495,000,000	90.2
Reciprocals:			
1943	66,000,000	49,000,000	73.9
1960	523,000,000	263,000,000	50.2

Source: Best's Fire and Casualty Aggregates and Averages, 1961.

In 1960 stock companies had a surplus ratio of 90 percent of premiums written, and in the same year the reciprocals had a policyholders' surplus ratio of 50 percent of premiums written, which was a reduction of approximately one-third since 1948.

In comparing surplus positions it must be remembered that stock companies have access to the capital market if they need to add to their surplus. Reciprocals do not. Because of lack of access to the capital market, reciprocals would be justified in accumulating a larger cushion for protection purposes, but they have not done so.

5. *Reciprocals do not operate like stock companies.*—A reciprocal exchange, as an insurance operation, does not operate like a stock company. The history of the reciprocal industry demonstrates that it has remained true to its original purpose.

Those contending that reciprocal exchanges operate in the same manner as stock companies overlook the complete difference in nature revealed by the figures:

Stock and reciprocal fire and casualty insurance returns to policyholders, 17 years, 1943–59

	Stock	Reciprocal
Underwriting income	$992,000,000	$396,000,000
Investment income and capital gains	5,574,000,000	91,000,000
Total	6,566,000,000	487,000,000
Returns to policyholders	$557,000,000	$335,000,000
Percent returned	8.5	68.8

Source: Best's Fire and Casualty Aggregates and Averages, 1960.

During the period 1943–59 reciprocal exchanges returned as savings to subscribers 68.8 percent their so-called underwriting and investment income. During the same period stock companies returned only 8.5 percent of their income to policyholders. That is, the percentage return to subscribers of reciprocals are 800 percent greater than the returns to policyholders by stock companies. This, then, is the essential difference in the operation of a reciprocal exchange as compared to a stock company.

The stock company, after providing the contracted service, has no further obligation to the policyholder. The profit that is made accrues to the benefit of third-party stockholders or remains in the corporation. The reciprocal exchange has a continuing obligation to the subscribers. That obligation is to return to subscribers the maximum amount of savings commensurate with the retention of the minimum amount of surplus consist with the security of the subscribers.

The maintenance of a minimum surplus must be considered as an essential part of the insurance operation and the establishment of such a surplus does not in any way diminish the fact that reciprocal exchanges have been operated for the sole benefit of subscribers.

6. *The additional tax imposed upon reciprocals by the H.R. 10650 could only be paid from savings which would otherwise be returned to subscribers.*—The effect of this bill would be to tax the savings of subscribers and to reduce the amount available for return.

To demonstrate this point it is necessary to refer back to the ratio of policyholders' surplus to premiums. At the end of 1960 the policyholders' surplus of stock companies amounted to 90 percent of premiums written, while in the case of reciprocal exchanges policyholders' surplus amounted to only 50 percent of premiums.

There is a point below which the surplus of exchanges cannot be reduced without endangering the financial security of the subscribers contracts of insurance. Comparing the surplus of exchanges with stock companies, it should be apparent that exchanges, having no access to the capital market, have what would appear to be a minimum amount in surplus.

If exchanges have accumulated no more than a minimum surplus and if they had been taxed at a 50-percent rate over the past 17 years, then it follows that the same surplus could have been accumulated only by reducing the savings returned to subscribers.

Comparison of present tax law and a 50-percent tax on underwriting gain on reciprocal exchanges, 17 years, 1943–59

	Present law	50 percent tax on underwriting gain	Increase or (decrease)
Underwriting income	$396,000,000	$396,000,000	
Returned to subscribers	335,000,000	274,000,000	($61,000,000)
Underwriting gain	61,000,000	122,000,000	
Federal income tax	0	61,000,000	61,000,000
Addition to surplus	61,000,000	61,000,000	0

The consequence would have been a direct tax upon the savings returned to subscribers. If returns to subscribers were not reduced and the entire tax were paid out of underwriting gain, then the surplus of exchanges would be reduced to only 38.5 percent of premiums whereas the stock companies have a 90-percent ratio of surplus to premiums. Even the latter situation results in a direct tax upon savings since it reduces the amount which in future years could be returned to subscribers.

INEQUITIES IN APPLICATION OF H.R. 10650 TO RECIPROCALS

H.R. 10650 gives only partial recognition to the needs of reciprocals by providing that a deduction for premium savings credited to subscribers account. We support this provision.

In other respects H.R. 10650 is grossly unfair and increases the existing tax burden on reciprocals over that of stock companies.

We urge modification in the following areas. Points 1, 2, and 3, following, apply equally to reciprocals and mutuals. Point 4 applies solely to reciprocals.

1. *Elimination of time and amount limitations on PAL account.*—The bill presently establishes a temporary deduction of 25 percent income plus an amount equal to 1 percent of incurred losses as a loss protective fund. Charged against this fund will be underwriting losses. At the end of 5 years, the major portion of the loss protection fund becomes taxable. The intent of the House of Representatives was to provide a safeguard against excess losses in recognition of the reciprocals' lack of access to the capital market.

The protection intended by the authors of the bill fails because the loss protective fund is limited by time and amount. The maximum benefit which can be realized by a reciprocal from PAL is one-eighth of the underwriting income, provided no losses have intervened to reduce the fund, plus the interest on the remainder of the account for a 5-year period.

This is grossly inadequate to provide the protection necessary for catastrophic years or to compensate for the stock companies' ability to obtain necessary financing through additional capitalization. We urge the committee to eliminate the time and amount limitations now imposed by H.R. 10650.

2. *Deletion of discrimination between dividend and nondividend paying reciprocals.*—H.R. 10650 provides that so-called policyholder dividends which create an underwriting loss shall be first charged against the PAL account to the extent that they create such loss before being used to offset investment income. There is really no difference between a reciprocal establishing a lesser premium in the first instance and a reciprocal which, through custom or for other reasons, matches that premium through the use of return of excess premium to policyholders (customarily called dividends).

The net cost of the policyholder may be the same as will the overall financial result to the reciprocal, yet this bill will produce totally different tax consequences. It follows, therefore, that the deviating reciprocals (those with an initial lower base rate) and a dividend-paying-type reciprocal each realize the same underwriting loss in bad years. In each case, the insurer should be permitted to offset the loss against current investment income before resorting to the P.A.L. account.

3. *Extension of small company relief.*—H.R. 10650 provides an exemption for mutual and reciprocal companies with gross receipts of less than $75,000; it provides an election to pay on investment income only where the gross receipts are between $75,000 and $300,000 and a diminishing deduction starting at $6,000 for those companies having gross receipts of between $600,000 and $900,000.

The proposed bill does not fully take into account the increases in property values and inflationary trends which have occurred since 1942, nor does it take into proper account the unstable experience of small companies. A company with less than $1 million in premium income simply does not have the ability to add to surplus through investment income or underwriting gain to adequately provide continuing protection to policyholders.

It is our recommendation that the relief to small companies be expanded by providing complete exemption to those companies with gross receipts up to $300,000 and the option of being taxed on the basis of investment income only for those companies with gross receipts of up to $1 million.

4. *Application of H.R. 10650 to reciprocals with corporate attorneys-in-fact.*—H.R. 10650 recognizes the difference between a reciprocal underwriter and a mutual insurance company, stating that the two differ in that the business of the reciprocal is conducted by two entities instead of one. The report points out that "regular" mutual insurance companies receive all of the premium income from insurance and, not only pay losses, but conduct directly the operation and management of the insurance activities, whereas the exchange portion of the reciprocal pays the insurance losses but the attorney-in-fact portion performs all or most of the insurance functions for a portion of the premium income of the exchange.

The report continues that if the total income were earned by a mutual insurance company, which performs these operations itself, it would constitute underwriting income and would not be taxed under existing law. The bill recognizes the reciprocals' unique form of operation and incorporates a provision permitting the reciprocal to combine the underwriting income of the attorney-in-fact with the exchange's underwriting income for offsetting underwriting losses in the exchange against the income of the attorney-in-fact to arrive at the total taxable income.

However, although recognizing this principal, H.R. 10650 does not permit the combining of the exchange's income and the attorney-in-fact income for the purpose of determining deferments into the protection-against-loss account or in computing the amount remaining in that account after the lapse of a 5-year period. In this regard, only the exchange's income is allowed to be a basis for computation. The bill ignores the fact that although the same amount of premium may go into a mutual as goes into a reciprocal, the mutual may retain a greater portion of that premium than a reciprocal with a corporative attorney in fact. In other words, a mutual can avail itself of tax benefits due to deferral of a portion of its entire underwriting gain. This is a significant advantage from a competitive standpoint. In no event will the granting of the privilege of combining the exchange's income with the corporate attorney-in-fact income to determine the deferral portion of the underwriting gain result in such a reciprocal paying a lesser tax than a mutual. In fact, it will make the taxes on each type of insurer exactly the same.

The only way to have tax equality under H.R. 16050 is to amend it to treat the total income of the reciprocal, including its two parts, in the same manner as the total income of a mutual insurance carrier.

APPENDIX I

RECIPROCAL INTER-INSURERS FEDERAL TAX COMMITTEE

Army Co-Operative Fire Association, Fort Leavenworth, Kans.
Automobile Club Inter-Insurance Exchange St. Louis, St. Louis, Mo.
Belk Stores Insurance Reciprocal, Charlotte, N.C.
Berwind Exchange, Philadelphia, Pa.
California State Auto Association Inter-Insurance Bureau, San Francisco, Calif.
Consumers & Disrtibutors Insurance Exchange, San Francisco, Calif.
Detroit Automobile Inter-Insurance Exchange, Detroit, Mich.
Erie Insurance Exchange, Erie, Pa.
Farmers Automobile Insurance Association, Pekin, Ill.
Farmers Insurance Exchange, Los Angeles, Calif.
Fire Insurance Exchange, Los Angeles, Calif.
Inter-Insurance Exchange of the Auto Club of Southern California, Los Angeles, Calif.
Inter-Insurance Exchange of the Chicago Motor Club, Chicago, Ill.
Lumbermen's Reciprocal Insurance Exchange, Little Rock, Ark.
Maryland Indemnity & Fire Insurance Exchange, Baltimore, Md.

Midwest Lumbermen's Inter-Insurance Exchange, Lincoln, Nebr.
Motor Club Insurance Association, Omaha, Nebr.
National Insurance Underwriters, St. Louis, Mo.
Old Hickory Insurance Exchange, Nashville, Tenn.
Prairie State Farmers Insurance Association, Bloomington, Ill.
Preferred Insurance Exchange, Seattle, Wash.
State Automobile & Casualty Underwriters, Des Moines, Iowa
State Automobile Insurance Association, Indianapolis, Ind.
Temperance Insurance Exchange, Walla Walla, Wash.
Truck Insurance Exchange, Los Angeles, Calif.
Union Automobile Indemnity Association, Bloomington, Ill.
United Services Automobile Association, San Antonio, Tex.

EXHIBIT II

Effect of H.R. 10650—Computation of reciprocal exchanges taxes, 1943–59

MINIMUM TAX

Underwriting income	$303,000,000
Less: Dividends to policyholders	237,000,000
Subtotal	66,000,000
Less: 12½ percent nontaxable	8,000,000
Net underwriting income	58,000,000
Income tax at 52 percent	30,000,000
Tax on investment income	6,000,000
Total	36,000,000

MAXIMUM TAX

Underwriting income	303,000,000
Less: Dividends to policyholders	237,000,000
Subtotal	66,000,000
Less: Nontaxable	----------
Net underwriting income	66,000,000
Income tax at 52 percent	34,000,000
Tax on investment income	6,000,000
Total	40,000,000

Senator LONG. As far as this Senator is concerned, it might be a mistake to have you answer questions. This Senator is sold. Senator Curtis may have some questions.

Senator CURTIS. I am sorry I did not get here at the beginning of your paper, but you represent a group of reciprocals?

Mr. DESMOND. Yes, sir.

Senator CURTIS. What kind of insurance do they write?

Mr. DESMOND. They will write fire and casualty insurance. Others will write a good bit of automobile insurance solely; others will write automobile and fire; some will write fire only.

Senator CURTIS. And they are the companies listed on——

Mr. DESMOND. On appendix 1.

Senator CURTIS. Appendix 1?

Mr. DESMOND. Yes.

Senator CURTIS. That is all?

Mr. DESMOND. That is the entire group of reciprocals I am representing. There is a total of 70 all together and we represent about 27

Senator CURTIS. Did you hear Mr. Wicker's testimony?

Mr. DESMOND. Yes, I did.

Senator CURTIS. Are you opposed to any of his recommendations?

Mr. DESMOND. No, sir; I am not.

Senator CURTIS. What additional things are you advocating for the consideration of the committee to meet what peculiar problems the reciprocals have?

Mr. DESMOND. If H.R. 10650 is adopted as the proper basis for taxing mutual and reciprocal insurance companies, we ask for the further provision that the underwriting company and the attorney in fact be allowed the 25-percent underwriting gain distribution under this protective loss account.

Senator CURTIS. Does that amount to taxing the two entities as one?

Mr. DESMOND. It has the effect of doing that, yes, sir.

Senator CURTIS. In other words, you feel that it should be regarded as one entity, the attorney in fact and what is it you call the other one, the exchange?

Mr. DESMOND. Yes, that is right. We are asking for that effect, yes, sir; that they be treated as a single entity, because the two entities represent our operation.

Senator CURTIS. And the reciprocal, instead of managing its own business, contracts with——

Mr. DESMOND. The individuals; that is right.

Senator CURTIS. As distinguished from mutuals?

Mr. DESMOND. Yes; that is right.

Senator CURTIS. Sometimes they contract with an individual; sometimes with a corporation as an attorney in fact?

Mr. DESMOND. That is right.

Senator CURTIS. But the attorney in fact has no other business that would appear in its income tax return other than the business done for a particular exchange with which it is associated; is that right?

Mr. DESMOND. Generally that is true. Now, you may have an occasional attorney in fact who has additional income from another source.

Senator CURTIS. If he is an individual?

Mr. DESMOND. Well, even a corporative attorney in fact may have it. But it is an unusual situation. It is possible for him to have some other income, say from renting or something of that sort. The bill would be designed to exclude that portion of the income from the combination.

Senator CURTIS. What you are saying in fact is that the attorney in fact's income comes from a given exchange and the exchange income should be treated as one entity?

Mr. DESMOND. Yes; that is it exactly.

Senator CURTIS. That is all.

Senator LONG. Thank you very much, sir.

You made a good case.

Mr. Charles T. Houston, speaking for American Reciprocal Insurance Association.

STATEMENT OF CHARLES T. HOUSTON, REPRESENTING AMERICAN RECIPROCAL INSURANCE ASSOCIATION

Mr. HOUSTON. Mr. Chairman, Senator Curtis, I am Charles T. Houston, manager of the American Reciprocal Insurance Association, with offices at 910 Commerce Building, Kansas City.

I have prepared a long statement which I would like to enter into the record, if I may, but I have also prepared a condensed one, which I think will fit within the time limitations.

Senator LONG. Do you have copies of your condensed statement? Would you make those available to me and Senator Curtis?

Senator CURTIS. May I ask a question first, Mr. Chairman?

Senator LONG. Go right ahead.

Senator CURTIS. Is your association one insurance entity?

Mr. HOUSTON. It is composed of 15 exchanges. Now, that list is not attached. If you would like a list, I will present it.

Senator CURTIS. Fifteen exchanges.

Mr. HOUSTON. Yes, sir.

Senator CURTIS. How many attorneys in fact?

Mr. HOUSTON. There are about 12 attorneys in fact.

Senator CURTIS. So some attorneys in fact are acting for more than one company?

Mr. HOUSTON. Yes, sir.

Senator CURTIS. Would you submit that?

Mr. HOUSTON. Yes, sir. I will do that.

(The following was later received for the record:)

AMERICAN RECIPROCAL INSURANCE ASSOCIATION

MEMBERSHIP LIST

American Reciprocal Insurers, Reciprocal Managers, Inc., managers, 2 Park Avenue, New York, N.Y.

California Casualty Indemnity Exchange, Index Underwriters, Inc., attorney in fact, 550 Kearny Street, San Francisco, Calif.

Canadian Reciprocal Insurers, Reciprocal Managers, Ltd., managers, 183 Bay Street, Toronto 1, Ontario.

Canners Exchange Subscribers at Warner Inter-Insurance Bureau, Lansing B. Warner, Inc., attorney in fact, 4210 Peterson Avenue, Chicago, Ill.

Casualty Indemnity Exchange, Manlin Service Corp., attorney in fact, 122 North Seventh Street, St. Louis, Mo.

Casualty Reciprocal Exchange, Bruce Dodson & Co., attorney in fact, GPO Box 559, Kansas City, Mo.

Consolidated Underwriters, T. H. Mastin & Co., attorney in fact, 1907 Grand Avenue, Kansas City, Mo.

Druggists Indemnity Exchange, Manlin Service Corp., attorney in fact, 122 North Seventh Street, St. Louis, Mo.

Lumbermen's Underwriting Alliance, U.S. Epperson Underwriting Co., attorney in fact, 5115 Oak, Kansas City, Mo.

Manufacturers & Wholesalers Indemnity Exchange, Hiram C. Gardner, Inc., attorney in fact, 2019 Stout Street, Denver, Colo.

National Insurance Underwriters, National Associated Underwriting Co., attorney in fact, 8030 Forysth Building, St. Louis, Mo.

Reciprocal Exchange, Bruce Dodson & Co., attorney in fact, GPO Box 559, Kansas City, Mo.

Retail Lumbermen's Inter-Insurance Exchange, O.D. Hauschild, Inc., attorney in fact, 5050 France Avenue South, Minneapolis, Minn.

Universal Underwriters, Lynn Underwriting Co., attorney in fact, 5115 Oak, Kansas City, Mo.

Warner Reciprocal Insurers, Lansing B. Warner, Inc., attorney in fact, 4210 Peterson Avenue, Chicago, Ill.

Senator LONG. Would you proceed, sir?

Mr. HOUSTON. Yes, sir.

Reciprocal insurance exchanges are neither stock corporations nor mutual insurance corporations. H.R. 10650 proposes to tax them as if they were mutual corporations, but their different characteristics have necessitated two substantial modifications in their treatment in order to avoid extreme hardship and unfair tax consequences.

The premium deposits paid for insurance at a reciprocal exchange are committed to an attorney in fact, usually a corporate agent, for disposition in accordance with specific directions. These funds do not belong to the agent or the exchange, but remain the property of subscribers who have paid them, for use only as directed. As we have previously testified before the Ways and Means Committee, in the House of Representatives, we think these funds should not be treated as income; the unabsorbed portion of the deposits at an exchange are savings to the subscribers and not income to anyone.

The first modification recognizes this principle. Reciprocal exchanges are permitted to deduct from taxable income, as defined in the bill, amounts credited to the accounts of subscribers but not paid out, provided the subscribers are entitled to withdraw the funds in their accounts on termination of their contracts.

This section rightfully recognizes that savings credited to the subscribers of a reciprocal exchange are the property of the subscribers and cannot be treated as belonging to any other person or entity for tax purposes.

The second modification applicable to reciprocal exchanges also arises from the difficulties created by attempting to tax an aggregation of individual taxpayers as though they were a single taxpayer. It permits the income of the attorney-in-fact—earned through serving the subscribers—to be combined with the excess of earned premiums over losses and expenses in order to simulate the income or loss picture of a corporate insurer. The combination of income procedure permitted by this section is elective. We approve of this section, but feel that it has a serious shortcoming, which I shall explain later.

Section 10 of this bill has as its main objective the imposing of a total income approach on mutual fire and casualty companies. Aside from the two modifications I have mentioned, reciprocals are to be taxed in all respects as mutuals. We have certain specific objections to the procedures applied to the mutuals which we share with the spokesman for the mutual industry.

Because of the particular problems of mutual insurance the bill would permit the tax deferral of certain amounts for the creation of a special account for protection against loss. This provision springs from the fact that nonstock insurers do not have access to the capital market, and therefore cannot obtain tax-free surplus from stockholders. To counterbalance this disadvantage they should have access to other tax-free funds in amounts sufficient to provide protection against extraordinary losses.

The bill therefore allows 25 percent of underwriting gain and an amount equal to 1 percent of the losses for the tax year to be transferred by mutuals to an account for protection against loss and to be exempt from taxation for 5 years. One-half of the 25 percent of

underwriting gain may be permanently transferred to the account, and be permanently exempt from tax subject to the limitations on use. As to all other amounts in the account, at the end of the fifth year, unused portions thereof must return to taxable income.

There is a major defect in this proposal as now drafted, however. Where a reciprocal exchange returns its total underwriting gain to its subscribers in cash or as credits to their accounts and the subscribers are business firms or corporations obtaining insurance for business purposes, there will never be any funds in the protection against loss account.

No underwriting gain will be eligible for placing in the account, and all the underwriting gain will be taxable to the subscribers to whom it has been returned. Moreover, even if some underwriting gain has been retained in past years, savings paid or credited to subscribers in excess of current underwriting gains must be first charged to the protection against loss account, thus assuring its depletion, and, in effect, denying the deferral benefits to any underwriting plan designed to provide insurance protection at actual cost by returning savings to policyholders. In other words, the benefits afforded by transfers to the account for protection against loss are substantially denied to reciprocal exchanges at which unused premiums and earnings on investments are customarily returned to policyholders as savings.

We strongly urge that this unfair discrimination against fully participating reciprocal insurance be removed. Such reciprocals should be afforded the same protective funds as others which do not return savings in any substantial amount. The subscribers at an exchange are equitably entitled to the same protective fund free of tax as that provided for a nonparticipating insurer.

I have previously referred to the provision permitting a reciprocal to combine the savings of subscribers and the income of the attorney in fact in determining income tax. The bill would not permit the income attributable to the attorney in fact to be used in computing amounts to be deferred for the protection against loss account. We believe this is an unfair denial since the purpose of that combination of income is to treat the subscribers at the exchange and their attorney in fact as a tax unit.

Our statement deals more fully with the serious faults we find in the bill and we submit that all of them can be removed without harm to the objective of equitably taxing all forms of fire and casualty insurance.

(The complete prepared statement of Charles T. Houston is as follows:)

STATEMENT BY CHARLES T. HOUSTON, GENERAL MANAGER, AMERICAN RECIPROCAL INSURANCE ASSOCIATION

My name is Charles T. Houston, and I am general manager of the American Reciprocal Insurance Association, with offices at 910 Commerce Building, Kansas City, Mo. This association consists of 15 reciprocal insurance exchanges located throughout the country, at which thousands of individuals, business firms and corporations exchange contracts of indemnity to protect themselves against property and casualty hazards. I submit this statement on behalf of the members of the association regarding H.R. 10650, introduced by Chairman Mills, of the Ways and Means Committee, and passed by the House of Representatives.

TOTAL INCOME APPROACH AND MODIFICATIONS

H.R. 10650, as reported by the Ways and Means Committee and passed by the House of Representatives, proposes a tax formula for mutual fire and casualty insurance companies, taxing such companies "on their underwriting profits, as well as on their investment income, substantially in the same manner as stock companies." (See Ways and Means Committee report.) The bill is described as "a modified total income formula."

Reciprocal insurance underwriting would be taxed as though the persons interchanging insurance contracts through an agency (attorney in fact) common to all, were a mutual insurance company. For convenience, I will refer to the participants in an interchange of insurance contracts on the reciprocal plan as "subscribers," the agency appointed by subscribers to exchange the contracts and provide required service as "attorney in fact," and the place of such interchange as the "exchange."

The special circumstances taken into consideration by the Ways and Means Committee of the House of Representatives included "recognition to the mutuals' lack of access to the capital market for funds with which to pay losses." The modifications are provisions authorizing the deferral of certain amounts, otherwise within "total income" and currently taxable, for limited periods, and the transfer of such deferred amounts to a special account for protection against losses.

An insurer would be authorized to transfer to a "protection against loss" (PAL) account a sum equal to 1 percent of insurance losses incurred during the taxable year, plus an amount equal to 25 percent of the ordinary underwriting gain. The amounts set aside within a given year may be used for paying losses as specified in the bill, but at the end of the 5th year thereafter the amounts in the PAL account, which have not been used for the payment of losses, must be returned to taxable income for that year, with one exception. One-half of that portion of the account attributable to the 25 percent of underwriting gain may be retained beyond the fifth year "as a cushion against extraordinary losses." There is an overall limitation in the total amount which can be accumulated, so that no increase in the account can be made from any source when, at the close of the tax year, the account is greater than 10 percent of the earned premiums, less dividends to policyholders for that year. As a matter of language, clarification of that provision in the bill may be needed, to assure that the limitation is 10 percent of the earned premiums, computed after dividends have been subtracted from the total earned premiums.

The bill provides for the order in which this special account is to be used, and under some circumstances a small portion of the account (one-half of the 25 percent annual deferral of underwriting gain) may be retained for an indefinite period, so long as within maximum limits of the account. A fundamental defect in this part of the proposal is the requirement that the additions to the account and dividends, when there is no current underwriting gain, must first be charged against the PAL account, and, only after exhaustion of the account, are these charges to investment income. This depletes the account in a participating insurer.

As an illustration, let us assume that in the first year after this bill becomes law a reciprocal exchange has incurred losses of $5 million, underwriting gain (premiums in excess of losses and expenses) of $100,000 and taxable investment income of $100,000. It distributes savings of $100,000, and transfers to the PAL account $50,000 (1 percent of losses for the year). There can be no transfer of 25 percent of underwriting gain because "statutory underwriting gain" is reduced by amounts distributed in savings and transferred to the PAL account. Therefore, underwriting gain or loss is computed by deducting from gains of $100,000 the sum of distributed savings ($100,000) and the transfer to the PAL account ($50,000), leaving an underwriting loss of $50,000. This must first be subtracted from the PAL account (to which $50,000 has been transferred), thus "wiping out" the account. These transactions leave taxable investment income of $100,000, which is fully taxed. This demonstrates that a reciprocal exchange distributing all underwriting gain to subscribers—fully participating—can never create a PAL account and all so-called income is fully taxed. Any amount transferred to the PAL account as 1 percent of losses is immediately "wiped out" as we have shown.

STATUTORY UNDERWRITING INCOME MODIFICATIONS—RECIPROCAL EXCHANGES

The proposed bill proceeds on the theory that mutual insurance companies and reciprocal insurance exchanges should be taxed alike—treating the reciprocal exchange as though it were a corporate taxpayer. These are procedures at war with each other; if reciprocal exchanges and corporations are taxed alike, there must be an appropriate formula recognizing the distinctive features of each. This recognition is extended, partially, through a provision in the bill which permits deduction of savings credited to individual subscribers' accounts at a reciprocal exchange as though the credits were dividends paid. This is some relief from the major dislocations that would arise from taxation of the subscribers in the aggregate as a corporate taxpayer, with subsequent taxation of those same subscribers individually. (This is discussed more fully in a subsequent part of our statement, giving more treatment to the nature of reciprocal exchanges.) If the exchange is to be taxed as though a corporation, the provision for deduction of amounts credited to subscribers accounts is a necessary recognition of the reciprocal method of underwriting. Without this provision, the resulting double taxation of subscribers' funds would be confiscatory in effect.

Another provision emphasizes the necessary adjustments if a reciprocal exchange is to be taxed as though it were a corporate insurer. This latter provision would permit a combination of the so-called income of an exchange with that of the corporate attorney in fact keeping records on the same basis as the exchange, in order to produce a result which is offered as more nearly simulating taxation of a mutual insurance company. This is done by permitting the reciprocal exchange to forgo deduction of business expenses arising from compensation paid to the attorney in fact, to the extent of the profit to the attorney from such compensation.

It is conditioned upon the ability to identify the income and expense items as those attributable to the insurance transactions at the exchange (see Ways and Means Committee report, p. 49). The privilege of combining income of the corporate attorney in fact and that of the exchange for tax purposes is optional, but an election to so combine is irrevocable except when permission is granted by the Secretary of the Treasury or his delegate. The arrangement cannot reduce taxes of the attorney in fact which must pay the same tax under any circumstances. However, the combination may prove desirable where the exchange is experiencing underwriting losses enabling recovery by the exchange of taxes paid by the attorney.

The permission to effect a combination of gains or savings at the exchange (to be treated as income of the exchange) with income of the corporate attorney in fact appears to be based on the fact that the reciprocal exchange is not an insurance company and inequities are inevitable when there is an attempt to apply a corporate tax formula to it. Therefore, this permissive arrangement is designed to relieve some of the unfairness and produce a less discriminatory tax result. We do not suggest that this is a satisfactory adjustment to compensate for the unrealistic treatment of a reciprocal exchange as a corporation, but we recommend that the privilege be retained in the bill so long as the reciprocal exchange is to be taxed as a corporate entity. We urge, however, that the transfer of underwriting income to the account for protection against loss should be from underwriting income of the combined "tax unit" and that denial of the transfer of income of the attorney contradicts the very purpose of the combination. It defeats the objective of permitting the combination to treat the exchange and attorney as a unit for income tax purposes and to equate reciprocal underwriting with mutual companies.

PROTECTION AGAINST LOSS ACCOUNT NOT AVAILABLE TO MANY RECIPROCAL INSURERS

The limitations imposed on the PAL account prevent it from carrying out its avowed purpose of giving the nonstock insurers a means of compensating for this inability to obtain tax-free surplus funds from the equity capital market. A reasonable adjustment in the bill can, and should, cure this obviously unfair discrimination. The PAL account accumulates most rapidly, and attains largest size at an exchange having substantial and consistent underwriting gain, but returning limited amounts to subscribers as savings. For example, the type of exchange which would benefit most from this deferral of income is that which realizes large underwriting gains and pays or credits little or no dividends or savings. However, we urge adjustment to afford proportionate relief where

there is no such consistent gain and to those exchanges which distribute their gains to subscribers. This need for relief is most acute as it applies to smaller exchanges, where the impact of a single large loss can be most serious and against which adequate provision must be made.

It is said that stock company insurers over the last several years have derived about one-fourth of their surplus funds from the equity capital market—tax free. If the objective of the PAL account is to give the reciprocal insurer a similar opportunity, the provisions of the bill certainly frustrate this objective.

The proposed PAL account is offered not only as a solution to the problem arising from lack of access to the capital market but, also, to provide a "cushion against extraordinary losses." Under the bill neither objective is even approached because of the severe limitations imposed and the rules under which the account must be depleted. The depletion affects not only the portion of the account which might be termed "capital funds," but it also destroys the "cushion against extraordinary losses."

We recognize, of course, that largest deferrals must necessarily arise where there is largest gain from which deferrals can be made. However, as we shall see, this bill contains a built-in denial of the PAL account for insurers which return all or most of their gains to policyholders in dividends or savings. This result arises from requiring depletion of the PAL account for distribution of dividends or savings in excess of ordinary underwriting gain, thus assuring that an insurer which distributes practically all gain or savings to its policyholders will never benefit from the modifications of the "total income approach"—will never have "protection against loss" in the manner provided. A fund for protection (cushion) against catastrophe cannot be created for such an underwriting operation. This is especially unfair and inequitable to reciprocal underwriting plans returning all savings to subscribers.

For an illustration, let us assume a requirement of State law that subscribers at a reciprocal exchange must accumulate a contingent surplus for protection of policyholders at the rate of 1 percent of net premium deposits (as New York does). If the total income approach is adopted, as this bill is now written, a reciprocal exchange would find it necessary to accumulate more than 2 percent of net premium deposits because of the tax impact. The protective or guarantee fund could not be established and maintained under the proposed PAL account. New York law will not permit impairment of the protective or guarantee fund by payment of dividends, savings, or refunds; yet the proposed PAL account in this bill is completely "wiped out" through normal distribution of savings where all savings (or most) are returned to subscribers. Thus, the proposed bill is completely out of harmony with regulation of reciprocal insurance in the largest insurance State. In effect, it will impose new and unanticipated burdens on reciprocals solely because they have to comply with New York law.

Perhaps it will be said that reciprocals can adjust their operations to the extent necessary to build the PAL account. This is best answered by a question: Why should the tax laws discourage, handicap, or force change in an insurance plan designed to provide insurance protection at actual cost with return of unused funds to subscribers? The purpose of the bill is to raise revenue and not to reshape and change the structure of the insurance industry. We submit that such a result is not intended.

To deny the benefits of the PAL fund to those insurers which return all of their underwriting gains and portions of their investment income to subscribers would penalize the traditional practice of reciprocal insurance underwriting at cost—making it necessary to retain substantial amounts of funds otherwise returnable to policyholders in order to build the PAL fund. In this way, the tax law would become a wrecking tool in destroying insurance underwriting at cost. We submit that this is contrary to the public interest, the national economy, and the policy of the Congress over a period of many years.

MODIFICATIONS NEEDED TO PREVENT UNFAIR DISCRIMINATION

We believe it will be helpful to examine more closely the fundamentals of reciprocal underwriting, to better appreciate our problem. Perhaps these are best demonstrated by contrasting the reciprocal exchange with the corporation, to which it is likened in the bill for purposes of taxation. The corporate insurer receives premiums which become the property of the corporation, and it realizes gain or loss from the insurance transactions arising out of the contracts in which the premium income is consideration for indemnities provided.

In the case of the reciprocal exchange, these transactions are fundamentally different. The exchange is not an entity capable of receiving and owning premium deposits or any property. All funds are placed in the hands of the managing agency, the attorney-in-fact, or as otherwise directed, under contractual authority to exchange contracts of indemnity and to perform those contracts on behalf of each subscriber. (Subscribers may be individuals, business firms, or corporations.) Each of the subscribers usually makes a deposit, which is intended to meet the obligations that subscriber has assumed, and the subscriber may or may not make additional commitments to meet greater obligations should the necessity arise. In any event, the deposited funds belong to the subscriber and must be used in meeting the obligations in exact conformity with the agreement appointing the attorney-in-fact. The contracts are always several, and there is no joint undertaking on the part of subscribers at any exchange. Each subscriber assumes and bears a proportion of the risks underwritten and, in turn, enjoys the protection provided by the other subscribers with whom contracts have been made. Under these circumstances, and in this plan of exchanging insurance contracts, it is obvious that any so-called underwriting gain is, in reality, nothing more than the saving realized by each individual subscriber, which may be termed the unused or unabsorbed portion of the premium deposit of that subscriber.

The interest of the insuring public requires regulation of transactions in the nature of insurance underwriting, whether by corporations, or by the interchange of contracts on the reciprocal plan. Since most of the insurance business is transacted by corporations, accounting procedures adaptable to those operations have been somewhat standardized, and the attorney-in-fact, representing subscribers at a reciprocal exchange, is required to adapt the transactions of the aggregation of subscribers to the accounting procedures of a corporate insurer. It is proper that such regulation exist, but it is unfortunate that the result has been to present the aggregate results of underwriting by subscribers at a reciprocal exchange as though the exchange were the insurer, and as though the results represented gain or loss to it. The reported underwriting gain for a reciprocal exchange is, in reality, a statement of how the subscribers have fared in their insurance costs by interchanging insurance contracts. That it represents income is completely fictional and, undoubtedly, accounts for the fact that it has been the policy of the Congress over the years to realistically recognize that the savings at a reciprocal exchange are the savings of subscribers and do not represent income of the exchange. It should be noted that the transactions of subscribers at a reciprocal exchange are reflected in the taxes of those subscribers, to the extent that savings are realized and deductible insurance expenses of the subscribers are correspondingly minimized.

The bill should permit transfers to the proposed PAL account without regard to whether savings are held at the exchange or returned to subscribers. The objective should be protection against loss. Creation of the PAL account should not depend on disposition of savings or retention of taxable funds at the exchange. The exchange is only a place at which the transactions occur, and the manner of holding surplus funds by an agency or the subscribers does not alter the need for the protective funds. Fairness requires that the proposed modification of the "total income" theory of income taxation shall not discourage insurance which operates on the principle that service and protection shall be provided at cost and unexpended deposits shall be returned to the subscribers.

Perhaps illustration would help clarify the problem. The bill would discriminate unfairly in the following way: Exchange A enjoys substantial underwriting gain (premium deposits exceed losses and expenses) and makes small or no distributions of savings. As a result, exchange A closes the tax year with combined underwriting and investment gain of $1 million, which it retains. It may transfer to the PAL account 25 percent of underwriting gains, plus 1 percent of losses incurred. Capital or surplus funds and a fund for protection against extraordinary and long-range losses can be maintained to that extent without tax consequences.

B is a reciprocal exchange and the subscribers there likewise enjoy substantial underwriting gain (premium deposits exceed losses and expenses). This is an exchange at which the subscribers are business enterprises seeking maximum service at actual cost as a business economy. Therefore, unabsorbed deposits are returned to the subscribers, along with investment income accruing on such funds. The tax year closes with combined underwriting and investment gain of $1 million, all of which is returned to the subscribers in cash, or credited to

accounts which may be withdrawn on termination of their contracts. In either case the funds are taxed as income of the subscribers. Exchange B can transfer nothing to the PAL account and must deplete anything previously transferred to such account before any investment income on funds of subscribers may be returned to them. Why the difference? The gain is held by subscribers instead of leaving it in a common fund at the exchange, held by their agent. The difference is in the plan of underwriting and should have no bearing on the tax treatment. If the subscribers choose to receive their own funds and the $1 million is divided into 10 accounts of $100,000 each, it is, nonetheless, underwriting and investment gain; yet a PAL account cannot be established by insurer B. Neither capital funds for protection of normal operations nor a "cushion against extraordinary losses" can be created; yet both are as essential, as they are to exchange A, in the example.

TABLE

	Exchange not distributing savings	Exchange distributing savings
Underwriting gain	$1,000,000	$1,000,000
Savings paid or credited	0	1,000,000
Underwriting gain	1,000,000	0
Transfers to PAL:		
25 percent underwriting gain	250,000	0
1 percent losses	50,000	50,000
Total	300,000	50,000
Taxable underwriting gain	700,000	(50,000)
Tax on savings to 10 subscribers	0	465,000
Tax to exchange	358,500	0
Discrimination	0	106,500

From these illustrations it is clear that both types of insurers should receive like treatment since the total gain is subjected to tax in both situations; one is permitted deferral of income while the other is denied the privilege. The subscribers at insurer B must pay the full tax on all funds, while insurer A enjoys the right to accumulate its PAL account for needed protection against insurance losses. It is not that A receives anything more than just recognition of a need, but we urge that B likewise receives such consideration. Nothing less is fair and equitable. There is no logical reason for the discrimination. If the proposed fund for protection against losses is to be meaningful and suitably related to the insuring functions it in intended to serve, there must be material alteration in the proposed formula for creating and maintaining the fund, so that it will not be destroyed by normal operations of the insurer and so that it can attain adequate size to afford reasonable protection.

The foregoing examples demonstrate the illogical results from the efforts to apply uniform treatment, for tax purposes, to corporate taxpayers operating for profit and aggregations of subscribers insuring each other with no element of profit.

If it is intended to recognize the inaccessibility of the capital market to nonstock insurers, there should be provision for the accumulation of untaxed funds in an amount approximating tax-free funds from equity capital available to the stock companies. The severely limited PAL account falls far short of that, and will not even approximate a reasonable need in the case of all reciprocal underwriters.

RECOMMENDATIONS

We urge the following modifications in section 10 of the bill to provide relief from its unfair treatment of reciprocal insurance:

1. Provide that, for the purpose of making additions to the account for protection against loss at an exchange where substantially all underwriting gain is distributed to the subscribers as savings, the underwriting gain shall be deemed the amount by which the premium deposits for the taxable year exceed losses and expenses, without regard to whether such savings are credited to accounts of subscribers or distributed in cash.

2. Provide that distribution of savings from investment gain shall not affect the account for protection against loss.

3. Provide that the account for protection against loss is not returned to taxable income at any time.

We also join in the recommendations of the spokesman for the mutual companies pertaining to the treatment of the small- and medium-sized companies.

Senator LONG. I understand that the Treasury opposed at one time the general theory under which reciprocals operate and are taxed. Are there not instances where a stock company will contract with an outside agency to do some or all of the things the attorney in fact does for the reciprocal?

Mr. HOUSTON. Well, sir, that is a little difficult for me to compare. I can understand that a stock company may contract with an agency.

Senator LONG. Well, as I understand it, the Treasury's argument was that the attorney in fact is merely getting a commission for the service he performs, just like any other employee or agent would get a commission for the service he performs and would be taxed on that basis.

Mr. HOUSTON. He is an agent to manage the reciprocal exchange business.

Senator LONG. The company could get a deduction for the fee they paid him and that would be the beginning and the end of it.

Mr. HOUSTON. I believe you are getting to the point of combining in order to compare with the mutual company. Is that what you mean?

Senator LONG. What I am trying to get straight in my mind is, What is the answer to that argument that the Treasury has made, along the line that I have indicated? Why should you not be taxed on the basis that the attorney in fact is merely getting a commission and that he has paid his commission and that you are entitled to a deduction for what you have paid him as a commission, and no more?

Mr. HOUSTON. I think our view would be that the attorney in fact is the management of the exchange just as a mutual corporation might have management, but of the same entity. In order to create a tax picture which compares, it has been suggested, and this bill proceeds along that line, that the two, the attorney in fact and the exchange, be combined, that the exchange will not in effect take a deduction for that portion of the compensation of the attorney which results in profit, but will combine the two, in effect, so as to produce an income picture that is like a corporation.

Senator LONG. Well, as I understand it, the Treasury has more or less receded from its position, perhaps reluctantly, but have apparently gone along with your argument that the attorney in fact should not be taxed just as any other employee or agent of a corporation would be taxed. But I wanted to get for the record from you a statement of the reasons why you do not think it should be that way.

Mr. HOUSTON. Well, this bill does treat it so, except that in computing the amounts to be placed in the deferred fund, you cannot use the income of the attorney in fact for that purpose.

Senator LONG. I understand the Treasury opposed that part of it. I wanted to get that straight, because I understand that is the issue.

Mr. HOUSTON. Yes, sir.

Senator LONG. Senator Curtis.

Senator CURTIS. Are your views in conflict with the previous witness?

Mr. HOUSTON. No, I don't think so. I think we are in agreement all the way.

Senator CURTIS. Now, does the exchange have underwriting gain or profit?

Mr. HOUSTON. In our view, Senator, the exchange has what we call savings. It is the remainder and it is——

Senator CURTIS. I understand that; that is more money taken from your members than you need?

Mr. HOUSTON. That is right, sir.

Senator CURTIS. Do you have underwriting gain?

Mr. HOUSTON. It is termed underwriting gain; yes, sir.

Senator CURTIS. Does the attorney in fact have underwriting gain?

Mr. HOUSTON. Only in the sense that if you combine the two, the portion of the attorney in fact as compensation which is profit is underwriting gain in the same sense that it would be in a mutual corporation.

Senator CURTIS. Now, while there are some attorneys in fact who act for more than one insurance company, more than one association, historically these things came into being with the intent of the members to create an insurance company and by contract, divided the functions between the exchange and the attorney in fact. Is that not right?

Mr. HOUSTON. May I explain, sir?

Senator CURTIS. Yes, sir.

Mr. HOUSTON. The origin of reciprocals, I think, was not to create a company but to create an underwriting service which did not exist then.

Senator CURTIS. All right. But their objective was to create an insurer; right?

Mr. HOUSTON. To insure among themselves; to exchange contracts; yes, sir.

Senator CURTIS. And they intended to create one complete unit to do that and it was divided into two parts; is that right?

Mr. HOUSTON. No, sir. I do not believe that is my understanding.

Senator CURTIS. Well, now, I will put it this way. Did the attorney in fact exist before the insurance company did, or did anybody organize an exchange without, at the same time, organizing or contracting with the attorney in fact?

Mr. HOUSTON. That is quite conceivable. I do not know that one ever existed without some agency serving it; no, sir. They began in America in about 1881 and it started in a very small way, a group of merchants, I believe, and they agreed to exchange their contracts to insure each other, to accept each other's liability, and the need of a managing agent to handle the interchange called for the employment of the attorney in fact.

Now, just when that occurred, I cannot give that much of the history.

Senator CURTIS. I think the California Motor Club is a reciprocal, and if I understand correctly, at the very time they organized the exchange, they contracted with their attorney in fact.

Mr. HOUSTON. I am sure this is true basically; yes, sir.

Senator CURTIS. To complete the setup, to handle the complete transaction of the members?

Mr. HOUSTON. Yes, sir.

Senator CURTIS. It is your position that for tax purposes, including the building up of reserves, it should be regarded as one entity?

Mr. HOUSTON. If it is to be taxed as an entity. I think that is where we need to remember that reciprocals, since—well, up to right now—have been recognized as not profitmaking entities so far as the exchange is concerned, that is an aggregation of individuals interchanging contracts not for profit at all, but the attorney in fact, of course, has been called an administrative agency and has paid taxes on income.

Now, the proposal would tax the exchange itself as a profitmaking agency. Well, our proposition here is that in order to make them like mutuals, we need this combining of the two. Because we have the management in one place and the insuring operation in another, if that is to be done.

Senator CURTIS. Then the answer to my question is that that is what you are proposing, treating the two as one entity for the purpose of applying this tax.

Mr. HOUSTON. Of applying this bill; yes, sir.

Senator CURTIS. All right. That is all.

Senator DOUGLAS (presiding). Thank you very much, Mr. Houston.

Mr. HOUSTON. Thank you.

Mr. Henry J. Clay, Committee on Fair Federal Tax Incentives.

I am mighty glad to have you here, Mr. Clay. You bear a famous name. We had a James K. Polk here last week and now we have a Henry Clay.

Are you a descendant?

STATEMENT OF HENRY J. CLAY, ON BEHALF OF THE COMMITTEE ON FAIR FEDERAL TAX INCENTIVES

Mr. CLAY. I am, sir. But like the story of the old potato plant, the good part is under ground.

Mr. Chairman, I have prepared a statement for the committee but I would prefer, although I recognize the long patience of the committee today, just to summarize the highlights of the statement orally.

The point that our committee is interested in is in section 14 of H.R. 10650.

Senator CURTIS. May I inquire for what committee you are testifying?

Mr. CLAY. Yes, sir. The committee is the Committee on Fair Federal Tax Incentives.

Senator DOUGLAS. Does that committee consist of representatives of the building industry?

Mr. CLAY. Yes, sir.

Senator DOUGLAS. Do you have a list of representatives?

Mr. CLAY. I have a list here.

Senator DOUGLAS. It will be made a part of the record.

(The document referred to is as follows:)

MEMBERSHIP OF COMMITTEE ON FAIR FEDERAL TAX INCENTIVES

Aveamerica Realty Corp., 475 Fifth Avenue, New York, N.Y.
Buena Park Co., care of William C. Brown, Jr., Post Office Box 308, 8031 Stanton Avenue, Buena Park, Calif.
Tishman Realty & Construction Co., Inc., 666 Fifth Avenue, New York, N.Y.
Wolfson Management Corp., 529 Fifth Avenue, New York, N.Y.
Oestreicher Realty, 6 East 53d Street, New York, N.Y.
The Kratter Corp., 521 Fifth Avenue, New York, N.Y.
Uris Buildings Corp., 850 Third Avenue, New York, N.Y.
Lazard Freres & Co., 44 Wall Street, New York, N.Y.
Pearce, Mayer & Greer, 41 East 42d Street, New York, N.Y.
Joseph Durst, 41 East 42d Street, New York, N.Y.
Benjamin Duhl, 20 East 46th Street, New York, N.Y.
William Zeckendorf, 383 Madison Avenue, New York, N.Y.
Eastman Dillon, Union Securities & Co., 15 Broad Street, New York, N.Y.
Association of Real Estate Syndicators, 48 West 48th Street, New York, N.Y.
Rose Associates, 529 Fifth Avenue, New York, N.Y.
Wein, Lane & Klein, 60 East 42d Street, New York, N.Y.
Helmsley-Spear, Inc., 60 East 42d Street, New York, N.Y.
The Futterman Corp., 580 Fifth Avenue, New York, N.Y.
United Improvement Investing Corp., 25 West 43d Street, New York, N.Y.
Wertheim & Co., 120 Broadway, New York, N.Y.
Weiler & Swig, 711 Third Avenue, New York 17, N.Y.
Realty Equities Corp. of New York, 666 Fifth Avenue, New York, N.Y.

Mr. CLAY. Section 14 of the House bill seeks to amend the present section 1231 by introduction of a new section into the code, section 1245, which seeks to tax all in 1 year at ordinary income rates the difference between the sale price of depreciable personal property and its depreciated tax basis or the adjusted basis.

Under the present law, section 1231, gains on the sale of capital assets and property used in trade or business are treated as capital gains. This favorable tax treatment was put into the present tax law for the very same reason that the President now urges your support for his investment credit; namely, as an incentive to business to invest in new equipment and replace obsolete equipment.

The President has stated that he thinks that the economy needs incentives and we certainly agree with him. We agree that there should be certain incentives or encouragements to industry to attract new investments in the modernization of plant facilities.

Incentive measures have always been a part of our tax structure and tax pattern and played a prominent part in our effort during the past three wars, and certainly, they are no less important today in the present cold-war crisis.

The Secretary of the Treasury has indicated that the present law was undertaken as an emergency measure and now he would like to retreat to the peacetime economy.

Well, one good fact is worth a shipload of argument, and I think that the national budget and the cost of maintaining the Military Establishment and the problems in this world of ours indicate that we are not in the peaceful economy that he would suggest. And the Government has consistently urged American industry to keep itself abreast of world affairs and to keep its tooling modern, due to the present world tension.

The proof of this is the very existence of the Business and Defense Services Administration. So therefore we say that the present law, which does have incentive features to encourage management to keep abreast of technological improvements is good, sound business.

We all agree that American industry must be kept up to date and abreast of all the improvements in production.

Senator CURTIS. Mr. Chairman, could I ask a question at that point?

Senator DOUGLAS. Yes, indeed.

Senator CURTIS. I want to make sure I understand what you are talking about.

Under the present law, if someone purchased a tool or a machine for a thousand dollars, since the 1954 act, it had a useful life of 10 years, so they started out under the declining balance to throw off 20 percent the first year, then 20 percent of $800 the second year; and so on.

After they had written it all off they sell that tool or machine for $300. Under present law, that is $300 capital gain?

Mr. CLAY. That is correct; yes, sir, Senator.

Senator CURTIS. And the Treasury proposed to make it ordinary revenue?

Mr. CLAY. That is correct.

Senator CURTIS. How much revnue are they going to bring in?

Mr. CLAY. They have indicated revenue in the approximate area of $200 million, I believe. I think Mr. Stam would probably be better able to give you the proper figures, but our position is, whatever the increase to the Treasury is, it will be offset by that figure which will deprive American industry to retool: This would discourage the replacement of equipment.

Senator CURTIS. I am informed by Mr. Stam that the estimate they now have is $100 million.

Well, now, what will happen in this transaction, in your opinion—will it slow up both the sale of property that has been fully depreciated—just slow up the sale of that, or will it slow up the purchase of new equipment?

Mr. CLAY. It will do both, Senator. The prudent businessman who might normally sell his equipment to meet the competition from West Germany or from the Common Market, he might very well dispose of his property at a profit above the adjusted basis, and that profit would be used to purchase new and more improved equipment in order to meet the competition from the Common Market. But if he had to pay ordinary income rates on the profit, that would necessarily deter him, in his good business judgment, because, not only would he pay the additional amount of money in income tax, and the new equipment that he replaces in most instances is more expensive than the equipment that he is now using.

Senator CURTIS. Using the illustration that I cited, and disregarding increased cost because of inflation for a moment, his decision to buy a new tool or machine for $1,00 might be dependent upon what he could sell the old one for any what he would have left after taxes after selling the old one?

Mr. CLAY. Well, Senator, that is only part of the answer. Ordinarily, what happens, is that that profit is usually the downpayment or part of the downpayment that he is going to use to buy new equipment.

Senator CURTIS. That is what I say; it would enter into his decision whether or not to get it?

Mr. CLAY. Undoubtedly it would, Senator.

Senator CURTIS. To that extent does it run contrary to another proposal of the Treasury for the incentive tax—to the objective, that is? They are quite different.

Mr. CLAY. They are two different propositions. In a sense what happens is that the investment credit of 8 percent is giving you a windfall on one hand or an incentive, and, under the recapture provision it is taking it out of the other one. They are contrary to one another, juxtaposed, in our opinion.

If I may proceed, Mr. Chairman?

Senator DOUGLAS. Yes.

Mr. CLAY. Under our system when business initiative is frustrated, our national economic life is bound to suffer. Our tax laws do a great deal more than raise revenue. They may encourage industries, they may destroy industries. We aren't urging here a windfall or a loophole as characterized by Mr. Dillon or a gimmick, but a realistic tax incentive for our economy for bona fide industry and for bona fide users.

We are not in favor of section 14. However, recognizing the realistic facts of life, that, in the event that in the good judgment of Congress this provision is introduced, this so-called loophole could be eliminated by providing that section 1231 be amended to increase the 6-month holding period to 5 years.

In this way the machinery which will incur substantial wear and tear and which is of a substantial nature and of a substantial cost, would not be penalized in its replacement by this harsh tax treatment, especially in the areas where technology is progressing, physically adequate equipment may very well become outmoded by newer models. Appropriate tax deductions from income to reflect these factors have always been recognized and should be continued to be recognized.

Now as an illustration of this point, I take an item like a printing press, which might have a livelihood of 10 years. It costs $10,000. At the end of 3 years—and it has a production of 1,000 impressions a minute—at the end of 3 years, through technocracy, a new type of press is introduced. Let us call it a jet press. This press costs $25,000. It will make 100,000 impressions a minute, and because of competition, the owner or the user of this press must acquire this to meet competition. So he disposes of his original machine, which he bought with the original expectancy of keeping it 10 years, let us say, at a profit above its adjusted basis. The adjusted basis is, say, $6,000, and he sells it for $8,000. But the cost of the new machine is $25,000.

What happens under the present law is that the difference between the $6,000 and the $8,000 is treated as a capital gain and he uses that difference, usually in the practice of the business, as a downpayment on the new, more expensive machine which he is having replaced.

Under section 14 of the House bill, as I have mentioned, the $2,000 of profit would be treated as ordinary income and he would be taxed at that rate.

Senator DOUGLAS. Mr. Clay, I have to leave in a minute, but I wish you would clear up a point of uncertainty in my mind that probably displays my ignorance.

You represent primarily the building construction industry and realty industry, but you are talking about a section which, as you say, deals with depreciable personal property other than building and structural components. Now I am a little puzzled as to what your economic interest is in this matter.

Mr. CLAY. Yes, sir.

Senator DOUGLAS. What is the thing that you are complaining about in the bill as it comes out; the machinery which is used in the construction of buildings?

Mr. CLAY. That is correct; yes.

Senator DOUGLAS. Hoisting machinery?

Mr. CLAY. Hoisting machinery, forklift machinery, any of the heavy equipment that goes into the construction of a building.

Senator DOUGLAS. Elevators?

Mr. CLAY. That is correct, and air-conditioning units. But I might say, parenthetically speaking, that this bill, section 14 as recommended by the House, goes into the area of pipelines, it goes into the area of streetcars, tank cars, and in Washington, D.C., alone, in its transit system, practically overnight they eliminated streetcars. Those streetcars obviously had an additional life of 10 or 15 years and they had to be sold to South America or some other country that uses streetcars.

If they made a gain on that unexpected liquidation of that division of their company, that gain presently, over the adjusted basis would be taxed at capital gains. Under the proposed law it would be at ordinary rates.

I might say again for emphasis, the reason I did not discuss real estate, which does not, and in the good judgment of the House committee, appear in the bill, is because we feel that the recaptured depreciation there would be a tremendous blow to the free exchange of real estate and to the tremendous expansion that has taken place in the real estate industry since World War II. On real estate we agree with the House bill.

Senator GORE. What about the fairness of taxation aside from whatever blow you think might occur? Taxation is a blow to all of us. It seems to me that people ought to pay taxes on the profits they make.

Mr. CLAY. This is depreciable personal property, Senator. The aspect of real estate comes under a completely different section.

Senator GORE. But you were speaking of real estate, though.

Mr. CLAY. I was just relating it in connection with the question from Mr. Douglas as to whom I represent.

Senator DOUGLAS. Well, suppose we were to put in the act the same provision as for depreciable personal property, but imposed your 5-year tax which you suggest here: It would be capital gains if sold in less than 5 years.

In other words, suppose we adopt your standard about applying that to buildings. Would you object to that? I think you may have given us a very valuable suggestion here.

Mr. CLAY. This recommendation was earlier made before the Ways and Means Committee in a little bit different recommendation, namely, that there be a holding period of a minimum of 3 years up to 6 years. We made this recommendation in connection with the real estate. I think in the good judgment of the Ways and Means Committee, they

decided to put this over until there was a more full study of depreciation in connection with real estate.

Senator DOUGLAS. They went you one better and completely exempted it.

Now what I am raising is we should take your very valuable suggestion of depreciable personal property and apply it to depreciable real property, would you not have made a really valuable contribution to the practice of taxation?

Mr. CLAY. I would like to avoid the answer to that question.

Senator DOUGLAS. I know you might like to avoid the answer, but I hope you will not avoid it.

Mr. CLAY. In direct answer to your question, Senator, we did make such a recommendation over on the House side, and it has been eliminated by the House, and I am satisfied with their view.

Senator DOUGLAS. I want to congratulate you.

Mr. CLAY. Thank you, sir.

Senator GORE. I take it you renew your suggestion here?

Mr. CLAY. Inasmuch as this is not a part of the present bill, I do not think it would be in good taste to recommend anything that is not in the bill.

Senator GORE. Well, that is not a valid premise. The bill is before the U.S. Senate. It can be amended in any way the Senate chooses.

Mr. CLAY. I recognize that, Senator, but it is not the bill before the Senate committee at the moment. It has not been amended.

Senator DOUGLAS. Well, this possibility is in the mind of the Senator from Illinois and I think in the mind of the Senator from Tennessee and you have strengthened the possibility very much by your desire to impose a 5-year limit in the case of depreciable personal property.

Mr. CLAY. Well, as you know, Senator, there was and we certainly do not accept this, a recommendation by the Secretary of the Treasury on a holding period for real estate. We say that this new concept of a holding period is acceptable to us. The period is not. If no period is good enough for real estate in the House recommendation, it certainly should be good enough for depreciable personal property used in the business.

Senator DOUGLAS. If your recommendation is good for depreciable personal property, it is good for real estate.

Senator GORE. You have made a fine contribution.

Senator DOUGLAS. Yes. I think it is a fine contribution and I want to congratulate you on your testimony.

Senator GORE. Unintended, perhaps.

Mr. CLAY. There is one aspect of this section 14 I would like to address myself to and that is the effective date of the act.

Senator GORE (presiding). You just used a term that I find some of my colleagues using. You want to address yourself to it. I think you want to address this committee to the subject.

Mr. CLAY. I beg your pardon, sir.

Senator GORE. I dare not, being a former country school teacher, correct any of my colleagues except by indirection.

Mr. CLAY. Yes, sir.

Senator, there is another aspect——

Senator GORE. You address the committee now, or yourself?

Mr. CLAY. Senator, there is a second aspect of section 14 which I would like to bring your attention to.

Senator GORE. Yes, sir. The committee will be pleased to hear you address it.

Mr. CLAY. Thank you, sir.

That relates to the effective date of the act. Out of the 21 sections of the proposed bill, we have calculated that 17 are prospective in the effective date. You will find that the effective date usually is related as to the period after December 31, 1962.

In this particular section, for reasons only known probably to the House committee, it has placed an effective date of December 31, 1961. We say that as far as the integrity of the tax laws are concerned, and a taxpayer depends upon those tax laws to guide his investment, that he is entitled, if by surprise or otherwise, there has been a decision to change the law, that he should be given a reasonable time in which to judge as to whether or not he desires to continue his investment in that field or whether he would like to alter his investment without punitive tax consequences.

So, therefore, we would recommend that the committee amend the date in section 14 to those periods of time after December 31, 1962, and the language for that amendment I have included in the prepared statement.

That, gentlemen, is my statement.

Senator CARLSON. Mr. Chairman, I just wish to state that I think Mr. Clay has given the committee some information that is very helpful. I have one or two questions here.

If you sell a piece of depreciated property for more than its undepreciated cost, is not that gain likely to be because you deducted too much depreciation?

Mr. CLAY. No, sir; not necessarily.

Senator CARLSON. Not necessarily?

Mr. CLAY. No, sir. If you are talking about long-life equipment, the used-machine market, in light of the increases in costs of new and more efficient machinery, the practice in the industry is that because of the period that is involved, depreciation does not take into consideration inflation and each year the dollar becomes smaller and smaller in its ability to purchase new equipment.

And we say that it is not because you have improperly depreciated or you have chosen an accelerated depreciation, but that this properly reflects the amount of inflation that has taken place between the time you originally purchased this piece of equipment and the time that you sold.

Senator CARLSON. Well, in case you did deduct too much depreciation in period of ordinary income, should not this gain also be viewed as ordinary gain? In case you did?

Mr. CLAY. In our view, Senator, we feel that if there was a gain over the adjusted basis, that this is a proper incentive to business, because where you are talking about depreciable personal property used in your business or occupation, that obviously, if you are continuing this business, that this money is undoubtedly going to be used to replace new equipment and to expand your business.

Senator CARLSON. Thank you very much.

(The complete prepared statement of Henry J. Clay is as follows:)

STATEMENT BY HENRY J. CLAY, COUNSEL TO THE COMMITTEE ON FAIR FEDERAL TAX INCENTIVES, ON TAX TREATMENT OF GAIN ON SALE OF DEPRECIABLE PERSONAL PROPERTY

Mr. Chairman, my name is Henry J. Clay. I am a member of the firm of DeWitt, Lockman & DeWitt, of New York, N.Y., counsel to the Committee on Fair Federal Tax Incentives, which is composed of representatives of the building construction industry, financial community and realty interests, principally located in the city of New York. Our committee is most appreciative for this opportunity to testify on the administration's tax proposals, now embodied in H.R. 10650, presently before you, which amends the Internal Revenue Code of 1954. Our specific interest relates to section 14 of the bill. This section provides that if depreciable property, other than buildings and structural components, is disposed of, there will be included in ordinary taxable income, in the year of disposition, any gain on the disposition to the extent that it represents depreciation taken after December 31, 1961.

SECRETARY DILLON'S RECOMMENDATIONS

In his statement before the Joint Committee on Internal Revenue Taxation, on January 18, 1962, Treasury Secretary Dillon has emphasized that it is the administration's declared policy to place American production on an equal footing with foreign competition. While there can be no disagreement with this general objective, certain provisions tend to mitigate the full effectiveness of such a program. One of these is the harsh tax consequences contained in proposed section 14.

Mr. Dillion has stated that "flexibility and simplification of the system of depreciation will require one important safeguard." This safeguard, he observes, is made available through the Treasury's proposal to tax, as ordinary income, gains from the sale of depreciable assets to the extent of all prior depreciation taken.

The proposal to change the capital gains treatment, in all instances, on the sale of depreciable property, regardless of useful life, would have a result at direct variance with the stated objective of encouraging investment in new, as well as used, machinery and equipment to stimulate American economic growth and would deter continual modernization of machinery and equipment to keep abreast of technological changes.

In view of the well-known disparity of production costs between the United States and other industrialized nations, we believe that it is essential that appropriate encouragement should be given to the continual growth of U.S. production capacity for home and foreign markets. Certainly, a blanket denial of the existing favorable tax treatment of gains resulting from the sale of long-life depreciable property would have an adverse effect on the efforts to make American production competitive.

SO-CALLED TAX LOOPHOLE INAPPLICABLE TO BONA FIDE USERS

Prior to the Korean war, personal property used in a business could be depreciated by one of several methods and, if sold or exchanged, any profit realized could be taxed on a capital-gains basis. In 1954, the rules for depreciation were changed, permitting "accelerated depreciation" but, in no event, below the salvage value of the property.

Nevertheless, the Treasury Department has come to regard all gains realized upon sales of such properties as resulting solely from excessive depreciation and, consequently, when sold, the capital gains treatment accorded such gains was called a loophole in the tax structure. The House bill purports to close this alleged loophole and substitutes a tax credit as to investments made in the future on certain new and old property. The bill eliminates capital gains treatment on the sale or exchange of depreciable property to the extent of all past depreciation and provides taxation on the basis of ordinary income. It is this provision of the bill to which we object.

Under the present law, a taxpayer invests in new equipment, having in mind the right to depreciation deduction against current income resulting from the use of the equipment. On the sale or exchange thereof, the resulting gain is treated as capital gains if the equipment was acquired as an investment for

use in the trade or business of the taxpayer and not, primarily, for sale. These tax consequences had an important bearing on making bona fide investment decisions with respect to acquisitions of new and used equipment. We are asking that the present law remain as it is.

NECESSITY FOR INTEGRITY OF TAX LAWS

We also believe that the recapture provisions of proposed section 14 would compromise the integrity of the Internal Revenue Code of 1954 which encouraged taxpayer investment within the framework of long-term capital gains and a more liberal depreciation policy. As a result of this liberal treatment, many taxpayers have made substantial investments which would not otherwise have been undertaken. These investments have resulted in a major contribution to our Nation's economy since the enactment of that code.

TAX TREATMENT OF LONG-LIFE DEPRECIABLE PERSONAL PROPERTY

Our committee is specifically concerned with the depreciation treatment accorded long-life equipment. It is sympathetic to the plugging of tax loopholes which have provided the short-term abuses complained of by the Treasury. If abuses have crept into the picture, we feel that they consist, principally, of treatment accorded short-life equipment. These abuses could be corrected if the right to capital gains treatment were limited to property held for a period of 5 years or more. However, investments which involve bona fide ownership and use of long-life equipment should not be affected by a proposed alteration of the capital gains tax treatment on casual dispositions of such equipment. The dispositions of such equipment play an important part in industry's ability to grow. It is essential that holders of long-life equipment be able to dispose of used machinery at prices reflecting the real purchasing power of the dollar at the time of replacement. The majority of industrial investors purchase long-life equipment not for tax benefits, but for legitimate business reasons. The real incentive to replace used equipment is based upon the desire of management to increase its productivity and profits. Should capital gains treatment be withdrawn, there will undoubtedly be a slowdown in replacement due to the additional tax burden incurred upon sale or other disposition. Actually, the loss of a more favorable capital gains tax treatment could well mean the difference between buying and not buying new equipment.

We believe that the long-range character of an investment in long-life equipment and the difference in the cost of financing such equipment, compared to relatively short-life equipment, are important considerations. Long-life equipment entails large capital costs which cannot be recovered out of profits from its use for a number of years. The user of such equipment normally has to borrow in order to finance its purchase and the terms of such borrowings are usually shorter than the expected useful life of such equipment. The income derived from the use of long-life equipment is pledged for a number of years to lenders but, nevertheless, is taxable currently to the owners who may not receive their profit on their risk equity capital until many years later. The risks of technical obsolescence in long-life equipment and inflationary cost of replacement are greater than in short-life equipment because of the long period of time it must produce profit, first to repay the debt incurred to finance it and, then, return a profit, if any, to the users. Capital gains treatment of such bona fide investors is not a loophole but, rather, an incentive needed to compensate for increasing financing costs and encourage the periodic replacement of long-life equipment.

DESIRABILITY OF RETENTION OF CAPITAL GAINS TREATMENT ON LONG-LIFE EQUIPMENT

Tax incentives, such as capital gains treatment on sale of property used in a trade or business and not held primarily for sale have always been a part of our tax policy and should not be removed indiscriminately, for the following reasons:

1. Tax incentives are necessary for the prudent financing of expensive long-life equipment.
2. Industry should be encouraged to purchase new and more efficient equipment without adverse tax consequences incurred in disposing of used equipment.

3. As a hedge against inflation, industry should use realistic factors in planning programs and budgets for the future. Tax provisions which do not recognize such economic facts of life, would necessarily increase such projected costs.

4. In any case, since the basic concept of depreciation is that equipment is used up in the production of income, any deductions taken, at least to the extent of straightline depreciation, should not be "recaptured" and taxed at ordinary income rates, upon sale. Under any theory, these deductions represent actual wear and tear of the property and are a current expense.

JUSTIFICATION FOR 5-YEAR HOLDING PERIOD

We feel that a 5-year holding period, as a basis for capital gains treatment of depreciable personal property, is reasonable and should be made part of the Government's tax policy for the following reasons:

1. It is almost impossible to calculate the effect or extent of inflation beyond 5 years.

2. It protects against excessive price rises of replacement equipment.

3. Commercial banks ordinarily restrict loans to 5 years—in actual practice.

4. Capital budgets are usually estimated on a 5-year basis; estimates beyond this period are purely speculative.

5. A 5-year holding period is a reasonable period within which to calculate wear and tear and obsolescence; calculations beyond this period are speculative.

6. The holding period will encourage investments and eliminate the abuses complained of by the Treasury Department.

EFFECTIVE DATE—CHANGE TO DECEMBER 31, 1962

I now turn to another part of the bill. H.R. 10650 is divided into 21 sections. It should be noted that the various revenue provisions, almost without exception, fix the effective date for taxable years beginning after December 31, 1962. One of the notable exceptions is section 14 which provides that the recommended change in the tax treatment of depreciable property should apply to dispositions made after the date of the enactment of the Revenue Act of 1962 and should relate to depreciation taken for taxable years beginning after December 31, 1961.

It is difficult to understand why the drafting staff has particularly segregated this section and affixed an effective date prior to the pattern fixed in the large majority of sections included in the proposed bill.

Although it is stated that the intent is that this provision shall not have a retroactive application, in reality, in does provide for recapture of depreciation taken after January 1, 1962. It is suggested that, to be consistent and equitable, the language in section 14 should be changed in the following manner:

"1245(a)(2) RECOMPUTED BASIS. For purposes of this section, the term 'recomputed basis' means, with respect to any property, its adjusted basis recomputed by adding thereto all adjustments, for taxable years beginning after December 31, 1962 * * *."

"1245(f) EFFECTIVE DATE. The amendments made by this section shall apply to taxable years beginning after December 31, 1962, and ending after the date of the enactment of this act."

We are urging deferment of the effective date of this proposed provision of law to permit the taxpayer to adjust his interest in the current year under the present law.

CONCLUSION

In summing up our position in connection with this proposed legislation, we urge that before any novel or drastic change in the tax treatment of depreciable property is adopted, many factors and their consequences should be thoroughly considered. It is inescapable that one of the contributing factors to the recent economic expansion of our Nation has been the favorable tax treatment of depreciable property used in a trade or business. The cold facts of the matter are that depreciation allowances and capital gains treatment have contributed to this country's post-World War II economic development. There continues a great demand in our country for continued modernization and expansion of industry. Constructive tax reforms are sound, but a tax policy which restricts growth or discourages initiative is "penny wise and pound foolish." The withdrawal of capital gains treatment on disposition of depreciable personal prop-

erty would, we respectfully submit, seriously hinder the President's program. It would curb investment incentives, hamper our economic growth, and contribute to further inflation. Capital gains treatment on the sale of long-life depreciable personal property should be retained for property held more than 5 years and as a proper incentive to encourage continued investment in new equipment for American industry.

Mr. CLAY. Senator, I would just like to note the presence of Mr. Markham, James Markham, my Washington attorney; Mr. Joseph Cass Woodle, our associate counsel, my New York attorney; and Mr. Charles Chohen, our accountant.

Senator GORE. The committee is pleased to note their appearance.

The committee will stand in recess until Monday.

(By direction of the chairman, the following is made a part of the record:)

VENTURA COUNTY MUTUAL FIRE INSURANCE CO.,
Ventura, Calif., March 28, 1962.

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

MY DEAR SENATOR BYRD: We call your attention to tax bill, H.R. 10650, regarding taxation of mutual insurance companies. We are very much concerned over this bill because in its present form it is extremely unjust to mutual companies as a whole and to small companies specifically.

The Ventura County Mutual Fire Insurance Co. has been serving its policyholders since 1898. Please understand that we do not oppose paying taxes and have been paying what we feel to be a just income tax. This present legislation is being pushed principally by Allstate Insurance Co. and it may well eliminate smaller companies such as ours if passed.

We feel that small businesses are what has made our country great and we urgently request that you oppose this legislation in its present form.

Sincerely yours,

RALPH H. BENNETT, *Secretary-Manager.*

WELLSBURG, W. VA., *March 27, 1962.*

Hon. HARRY FLOOD BYRD.
Senate Office Building, Washington, D.C.:

If proposed tax bill, H.R. 10650, becomes law, it will cripple and possibly force out of business many Farm Mutual Fire Insurance Companies in our State. This bill contains many unjust and antimutual provisions which will more than double our tax burden, stifle future growth, and force us to burden the farmers in our State with an increase in the cost of insurance.

We respectfully urge elimination of the unjust antimutual provisions in this bill.

WEST VIRGINIA ASSOCIATION OF MUTUAL FARM FIRE INSURANCE COMPANIES.
N. S. ARBUCKLE, *President.*
J. A. GIST, *Secretary-Treasurer.*

WELLSBURG, W. VA., *March 27, 1962.*

Hon. HARRY FLOOD BYRD,
Senate Office Building, Washington, D.C.:

Tax bill, H.R. 10650, as now proposed very damaging to our company. Our tax burden would become so great that we would be forced to raise insurance rates and financially penalize our policyholders, most of whom are farmowners.

We respectfully urge elimination of these harmful provisions in this bill.

MUNICIPAL MUTUAL (FARM) FIRE INSURANCE CO.,
MICHAEL DIFABBIO, *Executive Vice President.*

MIDWEST MORTGAGE CO.,
Louisville, Ky., February 21, 1962.

Hon. JOHN SHERMAN COOPER,
Senate Office Building,
Washington, D.C.

DEAR SENATOR COOPER: It has been made public knowledge that the House Ways and Means Committee has placed tentative approval for increased corporate taxation of mutual savings banks and withholding of tax on interest and dividend incomes.

This letter is being written to you as a means of protest against this action, and it would be greatly appreciated if my views would be presented to the committee so that they might take into consideration these viewpoints in their future study of this proposed taxation injustice.

As indicated by the letterhead on which this message is being written, I am engaged in mortgage banking activities. Such being the case, we are almost wholly dependent upon receiving funds from mutual savings banks and similar institutions for the purchase of mortgages in our operating area. Our mortgage activities are connected solely with the making of permanent loans to individual purchasers of low- and medium-cost housing.

An imposition of this withholding tax program on the mutual savings banks and similar institutions would seriously and drastically curtail the amount of funds that these organizations have heretofore channeled into the homebuilding market, and further, those funds which would be left available would come to us at such an extremely high cost that it would undoubtedly force the homebuilders to curtail and possibly eliminate their activities in this field. The reason being, that the cost of construction would become so great that in the final analysis the builder would be considered fortunate if he were able to operate on a break-even basis.

Another result that can be foreseen by this additional taxation is that there would be a substantial shift of savings from savings institutions to savings bonds, where the tax liability can be postponed for an indefinite period.

We need not look any further than our Canadian neighbors to see that this program was administratively impractical. The Canadian Government abandoned the withholding of income on investments after a short period of time.

It can also be added here, that the Housing and Home Finance Agency, the Veterans' Administration, and the Federal Home Bank Board, are all in agreement that the heavier taxation as proposed would lead to a reduction in savings inflow, which would in turn, conceivably result in a serious decline in mortgage lending and homebuilding.

The amount of funds savings banks would have in excess of the needs of their own local communities would decrease and their out-of-State lending would be curtailed sharply. Mutual savings banks hold $6.3 billion of mortgages on properties in nonsavings bank States, mainly in rapidly growing areas where the supply of savings from local sources lags behind mortgage demand. Moreover, if savings banks were permitted in effect a bad debt reserve allowance only against conventional mortgages, as is proposed by the Treasury stagg, their ability and willingness to acquire FHA and VA loans necessarily would be adversely affected. In lending on properties located in States other than those in which they are located, savings banks are limited largely to FHA and VA mortgages.

It is extremely urgent and important that you use every conceivable power and influence that you might have in opposing this impractical and unwieldy taxation program.

Very truly yours,

L. J. HARRIS, *Vice President.*

OHIO MUTUAL INSURANCE ASSOCIATION,
Bucyrus, Ohio, March 26, 1962.

Hon. HARRY F. BYRD,
Senator, Senate Office Building,
Washington, D.C.

DEAR MR. BYRD: I understand that the Senate Finance Committee, of which you are chairman, will soon have before it the new tax bill (H.R. 10650). There is a provision in this bill that changes the formula for the tax on mutual fire and casualty insurance companies.

I happen to be secretary-treasurer of a postloss mutual in Ohio, with more than 55,000 members. Ours is a nonprofit organization, and any safety funds that we are able to accumulate are held for the payment of future losses. If for any reason our association would cease doing business, any surplus funds on hand would be returned to the members.

I firmly believe that if we paid taxes on our taxable investment income, that we would be paying our fair share. In the past, our association has always paid more than that. We would figure our tax at the regular corporate rate on taxable investment income, and also at 1 percent of all of our assessment income and pay according to whichever was greater. This was a tax on misfortune, in that in the years when tornadoes caused heavy losses, our assessment would be higher, and to the extent that it was higher to pay the catastrophe losses, our Federal income tax was higher.

Inasmuch as the assessment mutuals do not have access to the capital markets to raise funds on which to conduct business, we do feel that such associations as ours could be hit by a catastrophic tornado at anytime, anywhere, should be able to create a tax-free fund in anticipation of such losses.

The proposed 1 percent of incurred losses and 25 percent of underwriting gain is not sufficient and there should be no time limit on such special loss-protection funds.

I think you will agree with me that too much of our legislation today is either to gain an unfair advantage or to stifle competition. This seems to be that type of legislation, and as it now stands, our assessment mutuals will be put at a very unfair disadvantage.

I have always admired your stand on fiscal matters, and I hope that you will do whatever you can to help us get this on a fair basis. We want to pay our fair share of taxes, and we will back you in any way that we can to achieve a balanced budget, and to eliminate wasteful and unnecessary spending.

Very truly yours,

PAUL KRAUTER, *Secretary-Treasurer.*

KENTUCKY MUTUAL AND CO-OPERATIVE FIRE INSURANCE ASSOCIATION,
Lexington, Ky., March 14, 1962.

Senator HARRY FLOOD BYRD,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: I am enclosing a copy of a resolution passed by the Kentucky Mutual and Cooperative Fire Insurance Association on October 25, 1961.

I hope you will give careful consideration to the contents of same and aid us in avoiding unreasonable conditions in the new revenue act, now before the House of Representatives.

Yours very truly,

W. G. READING, *Secretary-Treasurer.*

Whereas for several years organizations opposed to mutual insurance have expended hundreds of thousands of dollars in publicizing propaganda to the effect that mutual insurance companies were unfairly favored under the present Federal income tax laws; and

Whereas this effort on the part of commercial companies to use Federal taxes as a means of impairing the growth and usefulness of mutual insurance has had considerable effect upon the members of the Ways and Means Committee of the House of Representatives; and

Whereas in recent hearings before that committee tentative tax proposals have been suggested which in effect, would cause the Federal Government to penalize mutual insurance companies for natural growth and impair their ability to maintain a standard of solvency required to retain the confidence of conservative insurers: Therefore be it

Resolved, by the Kentucky Mutual & Cooperative Fire Insurance Association at its 55th annual meeting, held in Lexington, Ky., on October 25 and 26, 1961, That we protest the enactment of any revenue measure which treats additions to loss reserves of mutual companies as taxable profits, and fails to recognize the difference between underwriting profits which may be paid to stockholders

as dividends, from underwriting gains of mutual companies which must be placed in a loss reserve and which cannot be withdrawn for the personal gain of any individual; and

That we condemn tentative tax proposals before the Ways and Means Committee which obviously would penalize mutual companies because of growth or which would under certain circumstances, impose income tax upon such companies in years when the companies were operating with a deficit; and

That the proposal to permit a mutual company with a gross income of less than $300,000 to retain all of its so-called underwriting profits free from Federal income tax but when a mutual company had an income of $301,000 such sums would be taxed as much as 52 percent, is not only unfair, unjust, and unreasonable, but is a glaring example of the determination to use Federal income taxation to check the natural growth of mutual companies. This proposal must have originated from the same source that caused amendments to be offered before the last session of the Kentucky Legislature which would have prevented cooperative insurance companies from having more than $12 million insurance in force; and

That we earnestly request the Members of Congress to recognize the fact that no successful mutual insurance company has ever operated without making a material savings in the cost of insurance and that such savings increase the tax liability of the individuals and businesses carrying policies in mutual companies. We further request the enactment of statutes which are certain and definite in fixing the liability for taxes on mutual insurance companies and which do not leave the matter of tax liability subject to regulations by the Treasury Department; and

That a copy of these resolutions be mailed to the members of the Ways and Means Committee of the House of Representatives and to each of the U.S. Senators and to all State associations and to each mutual company in the State of Kentucky and to the Secretary of the National Association of Mutual Insurance Companies; and

That we further request the officers of all mutual insurance companies to contact as many of their members as possible and urge them to request their Representatives and Senators to use their influence to prevent competing companies from using Federal income tax laws to injure and destroy mutual insurance.

MOBILE, ALA., *March 12, 1962.*

Hon. LISTER HILL,
U.S. Senate Office Building,
Washington, D.C.
Hon. JOHN SPARKMAN,
U.S. Senate Office Building,
Washington, D.C.

DEAR SENATORS HILL AND SPARKMAN: I write you at this time about some of the proposals which are now pending before the Congress to change the tax laws by increasing taxes.

Perhaps I should acknowledge in the beginning that I am aware that those who have offered the changes to which I am adressing myself have euphemistically described them as proposals to "close loopholes."

It is my earnest opinion, however, that the changes to which I address myself do not represent the "closing of loopholes," but rather plainly constitute proposals to increase taxation, which have been thus labeled by the authors in an effort to avoid the measure of opposition which they would automatically arouse, even on the part of those not directly affected, if they were candid enough to correctly name their proposals.

First, there is the proposal before Congress which would tax as ordinary income gains realized from the sale of personal property which theretofore had been depreciated. If ever there was a proposed tax change which would directly and proximately deprive thousands of small businessmen of what may be their sole opportunity to acquire capital of their own, this is it. About the only opportunity that a small businessman who operates a garage or a small drilling business, or a small contracting business now has to acquire capital of his own is to buy equipment on time, pay for it out of earnings by virtue of depreciation credits, and then at some much later date when he has an opportunity to sell all or a part of his business, to take a capital gain such as is recognized by existing tax laws, and pay the lower rate of taxation thereon.

It is by such means that thousands of small businessmen have acquired the capital with which they thereafter went on and founded successful and larger businesses.

Furthermore, the ramifications of any such change in the law which could be brought about by administrative rulings of the Bureau could probably be extended so as to tax as ordinary income gains realized from the sale of securities when the real reason for the gain was the difference between depreciated value and the market value of depreciated personal property owned by a closely held corporation. Knowing the Bureau from long experience, this is not too much to expect.

The second proposed change to which I address myself is that under which real property owned by a U.S. citizen who dies while resident either at home or abroad would henceforward be included in his estate for the purpose of computing and paying U.S. inheritance taxes. At present, real property so held is not included in the gross estate of U.S. citizens for inheritance tax purposes. The reason for the existing rule under which such property is not now included in the estates of U.S. citizens for inheritance tax purposes is that since such real property is located within the jurisdiction of a foreign sovereign power, the levying of a tax by the United States directly upon or with respect to such property would constitute an invasion of the power of another sovereignty. This would be especially true should such property constitute, for instance, the sole asset of an estate of a deceased U.S. citizen, and the United States should attempt to collect taxes with respect thereto in a foreign country.

Unless within the recent past we have come to have less respect for the rights of other sovereignties, even if justified by an alleged need for ever increasing taxes, the basis for the rule of law which exists today is just as sound now as it was 50 years ago, and this alone would seem to compel the conclusion that there should be no change.

However, there are additional reasons which seem to me to militate strongly against the making of the proposed change, or any other.

The first additional reason is that if, for illustration, a U.S. citizen should die owning an estate valued at $10 million, consisting of $5 million of assets held in the United States and $5 million of real property held in Argentina, then the result which would surely come to pass is all too easy to anticipate—the Bureau of Internal Revenue would simply lay claim to the entirety of that part of the estate located within the United States and leave the heirs to their own devices in liquidating the property in a foreign land. Also, judging by my own experience with the Bureau while I was practicing law before the Bureau and the Tax Court of the United States, it would be all too easy for the Bureau to have the estate at its mercy by the simple device of arguing for an excessive evaluation of that part of the estate consisting of the real property held in the foreign land.

The second additional reason which, in my opinion, would persuade one that the law should be left as it is at present, is that there would appear to be neither a legal nor a moral basis for enacting such a law except the naked fact that the United States, under the prevailing construction of our Constitution, has the power to tax without limitation. Specifically, when I submit that there is neither legal nor moral justification for it, except as noted above, I have reference to the fact which has become all too plain and obvious in the recent past, namely that this country either will not or cannot protect the property of its citizens held by them in foreign lands. This is all too plain when one considers the recent debacle which took place in Cuba, while we did nothing. The lives of American citizens were in danger, their property, businesses, and homes were taken without indemnities or the payment of reparations, without the slightest suggestion that the U.S. Government would or could do anything about it. The assets of the American Sugar Refining Co., the International Telephone & Telegraph Co., and the holdings of the Rosenwald family in the Nacional Hotel, to mention only a few, were taken without compensation, and even more recently I understand that the American owned telephone system in Brazil has been expropriated with the suggestion that the Government of Brazil will pay $400,000 in indemnities, whereas the value of the property seized is said to have exceeded $10 million.

On what moral theory, then, can this Government levy a tax against the foreign real estate of a deceased person who dies while a citizen of the United States if this Government contributes nothing to the protection of the property?

I have limited this discussion to the possible effects of a change which would allow the levying of inheritance taxes with respect to real property held by

U.S. citizens in foreign lands, because real property is particularly and exclusively subject to the dominion of the sovereignty where the land is located.

I feel that the matters I have submitted herein have considerable merit, and I would appreciate it very much, therefore, if you would let me know what your reactions are to the thoughts which I have expressed herein.

Very truly yours,

BART B. CHAMBERLAIN, Jr.

CORPUS CHRISTI, TEX., *January 22, 1962.*

Hon. HARRY FLOOD BYRD,
Chairman, Finance Committee of U.S. Senate,
Washington, D.C.

Hon. WILBUR D. MILLS,
Chairman, Ways and Means Committee of the U.S. House of Representatives,
Washington, D.C.

DEAR SIRS: It is my understanding that the House Ways and Means Committee will reconsider its position with respect to the Treasury proposal relative to taxation of gains for income taxes from disposition of real properties. The change would be such that gains realized on disposition of depreciable real property would be taxed as ordinary income to the extent of depreciation claimed by taxpayer prior to disposition.

The undersigned is a member of the Tax Section of the American Tax Association and an active member of the section and committees thereof. The "Depreciation and Amortization Committee" of the section reported at the St. Louis meeting of the American Bar Association that "the committee has not as yet taken a position on President Kennedy's proposals" which included the proposal relative to tax treatment on disposition of depreciable real properties and personal properties. Thus, the comments hereinafter set forth are not in any way to be construed as being a position taken as a practicing tax lawyer. On the contrary, the position taken is set forth as counsel for the Corpus Christi Board of Realtors concurred in by the undersigned as a citizen.

The Corpus Christi Board of Realtors believes that in many, if not most, of the situations involving dispositions of depreciable real property as well as nondepreciable real properties, the gain, if any, obtained by the seller is attributable to inflation to a material degree. Thus the gain is not a true economic gain, but only involves the receipt of more dollars than was paid for the property, each of the dollars having lesser purchasing power than was true at the time of acquisition of the property by taxpayer.

We understand that some of the major problems confronting administrative policy of the administration to be as follows: preservation and restoration of foreign markets for American made goods by keeping American production competitive with products produced abroad; maintenance of high output of national gross product coupled with achievement of full employment to the maximum extent feasible; production of $92 billion of revenue in fiscal 1962 as a condition precedent of a balanced budget in fiscal year 1962; increased Federal expenditures, particularly in the areas of defense and welfare, which will consume all but about 1 percent of the projected $92 billion revenues.

Hon. Stanley Surrey, Undersecretary of the Treasury, and according to the understanding of the undersigned, a principal framer and legislative draftsman of the administration tax program, advised the tax section of the American bar in St. Louis in August, 1961, that the Treasury position was that competitive price of American goods could be achieved through technological improvement of American industry which must be stimulated through the incentive of granting tax benefits to industry in exchange for plant modernization with a view to production at cheaper cost through use of less labor. Not a word was said concerning compensation of the labor force on the basis of productivity in order to maintain competitive prices or otherwise controlling the labor cost included in manufactured goods. It was stated that unemployment created through technological industrial development would be handled by rehabilitation and relocation of the displaced workers, all presumably at Federal expense. The tax credits and benefits given for capital investment to stimulate production of manufactured goods with use of less labor would be offset, as I understand Mr. Surrey, by taxing gain on disposition of depreciable assets to the extent that depreciation has been taken thereon at ordinary income rates.

It is submitted that the proposals are economically unsound. The United States has contributed materially to the development of industrialization abroad, and now we find that manufactured goods are produced abroad with cheaper labor than is available to industry here, and sold here at prices below our production costs. In some instances, the raw material can be obtained in this country, shipped abroad, converted to manufactured goods, and returned to this country to be sold in the domestic market at prices less than the cost of producing similar goods by domestic industry. We see a paradox where an unemployment problem has been created by pricing our products out of world markets; and, by indirection, we export the jobs of our working force. It seems reasonable that any such incentive arrangement would merely compound the unemployment problem by eliminating in industries jobs which have already, through loss of world markets, reduced their production and labor force. It seems to me that the real economic truth is that we either must pay less for the labor included within the cost of our manufactured goods or we must increase the cost of labor included within manufactured goods produced by our foreign competitors. In this connection we might export a few of our labor leaders and let them incite workers abroad with their program for less productivity at higher wages in the industrial complexes we have helped create abroad.

To focus on the effect that elimination of capital gains treatment on disposition of depreciable real properties might well have in our area, the following observations are respectfully submitted. Probably the most depressed industry, apart from domestic crude oil production, in our area, is the construction industry. Residential building is extremely slow, and the only facet of the construction industry holding up at all is public works and commercial. Much of the commercial results from investor construction coupled with long-term leases to occupant users. There is no question but what tax shelter is some of the motivation for the construction. Recovery of cost through depreciation coupled with hedge against inflation through capital gains treatment on ultimate disposition is a definite factor in causing the investor to build in the first instance under circumstances where his yield on his investment is generally considerably lower than has been traditional in the real estate area. It is my conviction that the change of tax treatment will further retard commercial construction activity in this area and will create further unemployment among the construction industry which does employ considerable unskilled labor. We are told here that the biggest local unemployment problem is in unskilled labor.

It is further submitted, and most respectfully so, that it is improbable that revocation of the long traditional capital gain treatment on disposition of improved real estate will materially aid the Federal revenues and thus serve to offset depreciation credits proposed to be given on investments contributing to production of manufactured goods by use of less labor. The first result that will flow is that new construction will be retarded, perhaps nominally at first and then in increased amounts as the impact of taxable treatment of gain on disposition of improved real estate is fully realized by the lay public; and second, and perhaps more important and the first effect to be observed, will be that taxpayers simply will not sell at the price of paying ordinary income tax rates on the gain realized to the extent of depreciation theretofore claimed. In many instances the gain is less than the depreciation claimed, and it will convert all of the gain on disposition to ordinary income rather than capital gain. The impact of Federal taxation on gains realized by the seller on disposition of real property is, even at capital gains rates, a very material deterrent to dispositions of improved and unimproved real estate. The writer has long thought that capital gains treatment of sales of real etsate should be diminished and liberalized, particularly in the area of owner development through subdivision and retailing of lots. Such measures would considerably aid and abet prospective purchasers obtaining a site they would improve if the seller could be encouraged to dispose of it, and when the seller finds that the tax impact makes it impractical for him to dispose of it the result is that in many instances the property simply remains undeveloped and the investor utilizes his funds in other medias. The writer believes this not to be fictional or theoretical, but to be actual and real. If we are now to tax dispositions of improved real estate, as to the gain realized therefrom by the seller, at ordinary income rates, it can only keep many improved properties from being sold, and in many cases, left status quo in a quasi-obsolete state for use at less than highest and best use, and a prospective acquirer who might contribute to the economy and employment by acquiring the property and improving the exist-

ing improvements or replacing the existing improvements will not be able to acquire it simply because the owner won't sell. It seems to the writer that the ultimate Federal tax revenues might well be diminished rather than increased if the proposed legislation of the administration is enacted.

For the foregoing reasons, the undersigned on behalf of the Corpus Christi Board of Realtors and himself individually, respectfully, and urgently requests that no change be made in the taxation of gains on disposition of depreciable capital assets, both realty and personalty, and that, on the other hand, serious consideration be given to reducing capital gain rates on such dispositions and broadening the dispositions on which capital gains may be obtained, particularly with respect to owner-subdividers, it being observed that the present arbitrary and capricious rules with regard to improvements the owner might construct and the rapidity of sales of lots are unrealistic, preposterous, and absurd.

Be assured that the foregoing is offered in utmost sincerity and that all considerations given to the position stated will be greatly appreciated.

May both of you continue to display the courage of your convictions and rational practical conclusions which has heretofore so consistently been manifested in your actions as chairmen of your respective committees whose legislative recommendations so materially and vitally affect the economy of our Nation and each and every resident thereof.

With sincerest best wishes and kindest regards,

Very cordially yours,

WILLIAM H. BLOCH.

ROADWAY EXPRESS, INC.,
Akron, Ohio, March 30, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: As you will soon be taking tax legislation under consideration, I would like to express my personal views on several of the proposals embodied in H.R. 10650 as they will affect the motor carrier industry.

Secretary Dillon and other top Treasury and Internal Revenue Service personnel have referred to the "tax windfalls" resulting from the sale of depreciable assets, and the "rankling controversies" surrounding the question of salvage value. They have stated that treatment of the gain from the sale of equipment, as ordinary income, would eliminate most of the salvage value controversies.

It is my opinion that, under proposed section 14(c) of H.R. 10650, most of the controversies would not be eliminated but, rather, might be aggravated. Most of the controversies occur with taxpayers who replace equipment at the end of its economic useful life, which is shorter than the physical useful life of the equipment. Under the proposed new law such taxpayers will continue to face salvage value determinations (often made with the benefit of hindsight not available to the taxpayers).

Furthermore, the proposal will reduce the amount of depreciation such taxpayers are allowed under existing law. Presently, no salvage value is taken into consideration in computing depreciation under the declining balance method, whereas the proposal states that salvage value, up to 10 percent of basis only, need not be taken into consideration.

Capital gains treatment on the sale of depreciable assets has been a major factor in encouraging the replacement of outmoded, inefficient equipment. We have looked upon this as an incentive for maintaining a modern and efficient fleet, rather than as a "tax windfall." To the extent that the tax credit program would provide the necessary incentive, it might take the place of capital gains treatment. However, it should be recognized that the loss of capital gains treatment, together with the discriminatory effect of section 14(c), relating to salvage value in excess of 10 percent, far exceed the small benefit to be obtained under the tax credit in H.R. 10650.

The natural result would be that users of trucks, trailers, and other assets which have a short economic useful life, would retain their equipment for longer periods of time to obtain greater benefit under the tax credit proposal and, at the same time, avoid salvage value problems. This result is in direct conflict with the expressed intent of the proposed legislation, i.e., to encourage modernization and improvement of operating facilities, with a corresponding improvement in the general economy.

I urge that proposed section 14(c) be amended to provide that salvage value need not be taken into consideration for purposes of computing depreciation allowances, without reference to 10 percent or any other limitation.

I further urge that the 33⅓ percent and 66⅔ percent portions of the tax credit applicable to assets with short economic useful lives, as provided in section 2(b) of H.R. 10650, be increased to 50 percent and 75 percent, respectively, to more nearly offset the tax impact resulting from ordinary income treatment of gain from the sale of equipment.

Respectfully,

CHARLES F. ZODROW, *Assistant Treasurer.*

THE CRAWFORD COUNTY FARMERS MUTUAL FIRE INSURANCE CO.,

Bucyrus, Ohio, April 2, 1962.

Hon. HARRY F. BYRD,
Senator, Senate Office Building,
Washington, D.C.

DEAR SIR: I am writing you concerning the new tax bill (H.R. 10650) changing the formula for the tax on mutual fire and casualty insurance companies.

I am secretary-treasurer of a post-loss mutual in Ohio, with approximately 10,000 members. Ours is a non-profit organization, and any safety funds that it is possible for us to accumulate are held for the payment of future losses. This surplus fund of course, would be returned to the members in the event that our company should cease doing business.

The new bill (H.R. 10650) will not affect our company, due to its size, as much as it will larger companies, but it will stifle our growth and to my estimation, is very unfair and unjust to the mutual companies as a whole.

This bill denies and refuses equally appropriate treatment to fire and casualty mutuals because it includes an arbitrary unjustifiable 5-year time limitation and an unnecessary and unreasonable ceiling on the mutuals' loss protection funds.

We do want to pay our fair share of taxes, and feel that we have been doing so under the regular corporate rate or 1 percent of all of our assessment income (whichever is greater) and also feel that the new bill is very discriminating against mutuals and in favor of their stock competitors, which should not be.

We will certainly appreciate anything you can see your way clear to do for us in this important matter.

Yours very truly,

DWIGHT L. MUTCHLER,
Secretary-Treasurer.

THE UNITED HOME MUTUAL INSURANCE CO.,
Bucyrus, Ohio, April 3, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR MR. BYRD: I understand that H.R. 10650 is now before the Senate Finance Committee.

We call your attention to this bill, as it affects mutual fire and casualty insurance companies as a whole. If this bill becomes a law, in its present form, it will be terribly unjust to the mutuals.

This new tax bill actually discriminates against mutuals and is in favor of their stock competitors. As it now stands, this bill would practically stifle necessary wholesome growth of many mutuals, and it would prevent large numbers of companies from accumulating and maintaining reasonable adequate surplus for the protection of the policyholders, and the public.

The propriety and necessity of appropriate tax deferrals to enable mutuals to accumulate and maintain adequate special loss protection funds, without any sort of time limitations, has been recognized, quite properly, by Congress in the recent life insurance tax law.

Furthermore, it is also recognized, quite properly, for mutual banks and savings and loan companies in the present proposed tax bill itself.

However, this bill denies and refuses equally appropriate treatment to fire and casualty mutuals, because it includes an arbitrary unjustifiable 5-year time limitation and an unnecessary and unreasonable ceiling on the mutuals' loss protection funds.

Unless these unjust and unreasonable discriminations are eliminated or corrected by the Senate Finance Committee, this bill will do untold harm, not only to mutuals, but also to their policyholders, and especially to those mutuals which write tornado insurance and casualty insurance within a limited territory.

Your help and assistance in this matter will be appreciated.

We also wish to express opposition to the withholding tax on dividends, not only because of the increased bookwork it will cause our financial institutions, but because many of the "little fellows" will not go to the trouble to seek the refund, which they would be entitled to.

Very truly yours,

H. E. HUDDLE, *Secretary.*

MUTUAL INSURANCE COMPANIES ASSOCIATION OF INDIANA,
Indianapolis, Ind., April 10, 1962.

Re H.R. 10650.

Senator HARRY BYRD,
Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: This association represents 68 mutual fire and casualty companies throughout the State of Indiana which, in turn, protect many thousands of policyholder members.

In order to determine the effect of the tax formula provided in the above bill, several of these companies have made actual computations which indicate, without doubt, that Federal taxes for some of them would increase four and five times and possibly even greater, if this bill is passed without amendment.

One company found, as an example, that its taxes on 1 year's operations would be $40,000 on the old basis but would jump to $202,000 under the above bill.

By actually applying the formula to the operations of members companies, we have found that this bill, if passed without amendment, would place the safety funds of member companies in serious jeopardy. This means, of course, that they would eventually simply not be able to pay losses due to Federal taxation providing an excessive drain on surplus funds, preventing any buildup in these funds—which is a necessity for the payment of losses and the protection of policyholders who own the companies.

We would like to urge your committee to especially examine the operations of companies having less than $5 million annual premium income and even those with less than $10 million annual premium income since it appears that the smaller companies in those brackets will be most seriously effected by this legislation, which may eventually force some of them to close their doors.

If the committee or a special subcommittee at your disposal could work from the figures in "Best's Insurance Guide" and apply the formula provided in H.R. 10650 to all sizes of companies—especially including the smaller ones, I am sure that you would find, as we have, that the bill in its present state provides far from an equitable solution.

Mutual companies have no objection at all to paying Federal taxes. In fact, a study by our association indicates that in many cases mutuals have paid more taxes during past years than stock companies of comparable size. In addition, some stock companies have even received Federal tax refunds when mutuals have not. All of this information is readily available in "Best's Insurance Guide With Key Ratings."

There is, of course, a distinct difference between stock and mutual types of operations. If mutuals do not have enough surplus funds, they cannot sell stock to get more money as stock companies can. Since mutual company assets must be kept in the most liquid form, especially with reference to catastrophe claims, they are very much restricted on how much they can invest in nonliquid-type investments. This, of course, is contrary to the stock operations which many times indicates that stock companies count on their investment income carrying them along.

We are certain that your committee will do everything possible to amend this bill in order to insure that it has a fair and equitable application. In summary, if you pass H.R. 10650 as it is now, thousands of policyholders, not just companies, are going to be affected.

We are certain that the administration, while apparently believing in the need for additional taxation, did not at the same time want to have companies

fall by the wayside or have their operations otherwise placed in such jeopardy that a negative effect on our overall economy would be realized. We are confident, too, that you would favor fair and equitable treatment for all types of companies.

A delegation from this association will visit your committee hearing on Friday, April 13. Meanwhile, we would sincerely appreciate your opinion and hope that you will go along with us in urging a more thorough analysis and application of the formula in the bill of the various type mutual operations and subsequent amendment so as to prevent a disastrous effect upon hundreds of mutual companies throughout the Nation.

Sincerely,

ROBERT L. BENJAMIN, *Secretary.*

COSMOPOLITAN MUTUAL INSURANCE CO.,
New York, N.Y., April 4, 1962.

Re H.R. 10650, proposed new tax bill.

Senator HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR: Our company is a mutual casualty insurance company, organized under the laws of the State of New York and has actively been engaged in writing insurance business in this State since 1924. Since that date, we have returned to our policyholders the sum of $24,650,000 in the form of dividends.

We respectfully request that you do all in your power to vote for the elimination of the unjust antimutual provisions of that bill since it actually discriminates against mutual casualty insurance companies and in favor of their stock insurance company competitors.

We realize that our company should bear its just share of the tax burden but we claim that the present provisions of the bill result in an unjust burden upon the mutual companies, both large and small, and have the effect of crippling their growth.

By prohibiting the use of our investment income for policyholder dividends, unless and until our loss protection funds are completely exhausted, it discriminates against us and in favor of our stock company competitors who are permitted to pay dividends to their stockholders out of investment income. The bill fails to take cognizance of the fact that investment income is earned as a result of using the policyholders' premium dollar.

The bill would stifle the wholesome growth of mutual companies which are nonprofit organizations returning their savings to the policyholders. A mutual insurance company has no stockholders. Ownership resides in the policyholders. The company's sole function is to provide insurance coverage for its policyholders at the lowest possible cost consistent with safety.

In the recent life insurance tax law, Congress recognized the propriety and necessity of appropriate tax deferrals to enable mutuals to accumulate and maintain adequate loss protection funds without any time limitation. This is so because mutual companies, unlike stock companies, in times of heavy losses, have no access to the capital market. If this principle is sound for mutual life insurance companies, why is it not applied to mutual casualty companies as well? Incidentally, the same principle has been applied by Congress in the very present tax bill for mutual savings banks and savings and loan companies. The present bill denies equal appropriate treatment to mutual casualty companies because it includes an arbitrary unjustifiable 5-year time limitation and an unnecessary and unreasonable ceiling on the mutual loss protection fund. This will result in irreparable damage to mutual companies and their policyholders.

I hold myself ready to further discuss this bill with you if you should find it necessary or advisable to do so.

We urge you to vote for the elimination of these unjust antimutual provisions in the proposed tax bill as indicated herein.

Very truly yours,

EMANUEL MORGENBESSER,
Secretary and General Counsel.

FARMERS' MUTUAL FIRE INSURANCE CO.,
Stockton, Calif., April 10, 1962.

Re tax bill H.R. 10650, public hearing.

Hon. HARRY F. BYRD of Virginia,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: We are informed that hearings on the above bill will soon commence.

This letter refers to the portion of the bill that deals with the taxing of mutual fire and casualty companies and particularly the portion that provides a 5-year limitation and a ceiling on the mutuals' loss protection funds.

Congress has recognized the need and the propriety of tax deferrals to enable mutuals to accumulate and maintain adequate surplus for policyholder protection in the recent life insurance tax law. This present tax bill also recognizes this fact in regard to the mutual banks and savings and loan companies. These deferrals do not have the limitation or ceiling.

The discriminatory provisions of this bill against the mutual fire and casualty companies will be harmful to these companies and their policyholders and will prevent many mutuals from accumulating and maintaining adequate surplus funds for the protection of the policyholders and the public, and will tend to stifle desirable competition.

We urge your sincere consideration and your urgent effort to assist in eliminating these provisions.

Very truly yours,

R. T. ELIASON, *Secretary.*

PENNSYLVANIA LUMBERMENS MUTUAL INSURANCE CO.,
Philadelphia, April 13, 1962.

Senator HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Your Finance Committee is now considering House bill 10650, Revenue Act of 1962.

Those of us associated with the mutual property insurance industry are terribly concerned about the section of this law that provides for the setting aside in a protective fund, 1 percent of losses paid and 25 percent of underwriting profit.

If there have been no demands on this protective fund, it would not have used up the first year's appropriation. After 5 years, beginning with the sixth year, the amount set aside 5 years earlier must be returned and treated as income for that year.

As a mutual company we have no other means of providing capital for our business other than through expanding the medium of underwriting profit, appreciation on our investment portfolio, and our investment income.

On the basis of the law under which we are now working if there is an underwriting profit it becomes available as additional surplus to be used for supporting expanding business.

Under the new law at least one-half of the protective fund, if it is not used for excess losses, would be taken for taxes.

Since our companies will continue to be taxed on our investment income and our portfolio appreciation, it leaves us no opportunity to provide increased strength for growth.

I am certain you realize the great need for keeping strong the property insurance section of the industry.

Naturally, we are vitally interested in the treatment mutual insurance companies will be getting in this law that has now been proposed and passed by the House.

I understand that savings and loan associations and factory mutual insurance companies have received consideration on most of the requests that were made to the House committee. Unless the mutual property insurance companies can get some consideration, there will be left no incentive for the creation of new companies to handle the expanding business that the future years will develop.

We hope you will be able to appreciate the position the mutual fire and casualty companies will be in if the request that we make in this letter doesn't receive consideration.

Sincerely,

FRED H. LUDWIG, *Chairman.*

PRENTICE-HALL, INC.,
Englewood Cliffs, N.J., April 11, 1962.

ELIZABETH SPRINGER,
Clerk, Senate Finance Committee,
Washington, D.C.

DEAR MADAM: In connection with the current hearings by the Senate Finance Committee on the Revenue Act of 1962, H.R. 10650, I desire to submit the enclosed material. It is in the form of a series of memorandums, each dealing with a separate issue.

My conclusions are the result of an analysis made of proposed section 1245, the "recapture of depreciation" provision, in connection with my work at Prentice-Hall. (I am an editor on the staff of the Lawyer's Weekly Report and the Accountant's Weekly Report, both publications by Prentice-Hall in the field of Federal taxes. I enclose an issue of our paper with an article of mine which explained the recapture provisions in general language for our readers.)

Briefly, the material being submitted touches mainly on points of draftsmanship in the partnership area. It became clear to me that section 1245 as drafted would have many side effects on partners and partnerships that perhaps were not contemplated by the draftsmen. In some instances there are loopholes, in others drastic effects harmful to taxpayers which are not discussed in the House committee report.

In memorandums dealing with basis, death of a partner, current and liquidating distributions, collapsibility, and other problems of partnerships, these effects are explained and appropriate corrections suggested.

Other memorandums deal with some undesirable effects of section 1245 on section 333 liquidations, some ambiguities in the definition of section 1245 property, and an ambiguity in the mutual savings bank legislation (proposed sec. 593(f)).

The opinions expressed in these memorandums are, of course, mine alone and do not necessarily reflect the opinions of Prentice-Hall.

It should not be necessary to appear and testify in person. Of course, I shall be glad to be helpful in any way as to my point disucssed in the material submitted.

Very truly yours,

JOHN B. SHEPPARD,
Editor, Weekly Letters Department.

[Lawyer's Weekly Report, Apr. 9, 1962]

HOW THE NEW DEPRECIATION RECAPTURE PROVISIONS WILL HIT YOUR BUSINESS

Soon, your business will be paying higher taxes on turnovers of machinery and equipment. That's in store under the new Revenue Act of 1962—passed by the House and now before the Senate.

As things now stand, if you sell depreciable property at a profit, your whole gain is favorably taxed capital gain. After it's law, new section 1245 will turn part of this gain into ordinary income—the part that represents your post-1961 depreciation deductions. But the rest will still be capital gain.

What's more, new section 1245 will create income where it's never existed before. It'll tax corporations on dividends and liquidations, partners when they withdraw or sell their interests. It also affects gifts, some like-kind exchanges, and involuntary conversions.

But, under the House bill, one big class of property—buildings and their structural components—will continue to be free of the recapture provisions.

How recapture works.—The new law recaptures only post-1961 depreciation deductions—the past is forgiven. The key idea here is "recomputed basis." It is simply the adjusted basis when you sell plus all depreciation or amortization deductions in tax years beginning January 1, 1962, and later. Any gain up to your recomputed basis is ordinary income; anything above that continues to be capital gain under section 1231.

Suppose you sell a business machine for $15,000 on January 1, 1963. Here's how it would work: The machine has an adjusted basis then of $10,000 and your depreciation deduction in 1962 was $2,000. So your recomputed basis is $12,000.

Amount realized	$15,000
Adjusted basis	10,000
Gain	5,000
Recomputed basis	12,000
Adjusted basis	10,000
Ordinary income	2,000
Capital gain (sec. 1231)	3,000

There's a limit on recapture.—If you sell for less than the full recomputed basis, your ordinary income is limited to the actual gain. For example, if you had gotten only $11,000 for the machine (instead of $15,000), your recomputed basis would still be $12,000, but the ordinary income would only be $1,000, the actual gain. There would, of course, be no capital gain in this situation.

No income on gifts—but the donee carries your burden.—You can give away section 1245 property without realizing income. But here—as in other carryover basis situations we'll discuss below—the property carries over your section 1245 potential.

Example: In 1965, you own section 1245 property with value of $150,000, adjusted basis of $90,000, and post-1961 depreciation deductions of $50,000. You gave it to son and pay a gift tax of $25,000. Here's how things shape up:

Carryover basis	$90,000
Gift tax paid (sec. 1015(d))	25,000
Son's adjusted basis	115,000
Adjusted basis	115,000
Carryover, sec. 1245 potential	50,000
Son's recomputed basis	165,000

So if son now sells for $150,000 before taking any depreciation deductions, his ordinary income is $35,000 ($15,000, lower of amount realized and recomputed basis, minus $115,000 basis).

Gifts to charity also have a stinger.—No income from the gift, but the amount of your charitable deduction will be cut down by the section 1245 potential. So on the facts in our example, $50,000 of your charitable deduction is lost, and your deduction is $100,000.

Death transfers are the exception—there is no income and no carryover of section 1245 potential. So if son acquires the property on father's death, his new basis (death value) is $150,000; on sale for $160,000 before son takes any depreciation deductions, he has $10,000 capital gain.

Involuntary conversions.—Very generally, if an involuntary conversion is tax free, there's no section 1245 income then and the section 1245 potential carries over to replacement property. However, to the extent gain is recognized, it will be ordinary income up to the section 1245 potential.

Take some facts. Your property is destroyed or (condemned). Basis of business machinery was $100,000, insurance proceeds were $117,000, and recomputed basis $116,000. Let's look at the two most likely cases.

First, supose you elect tax-free replacement, and the new machinery costs $114,000. Since your recognized gain is $3,000 ($117,000, amount realized, minus $114,000, cost of replacement), only $3,000 will be section 1245 income. Of course, the replacement property carries over the old property's section 1245 potential—presumably here only $13,000, since $3,000 of the original $16,000 has already been taxed.

On the other hand, let's say you don't elect tax-free replacement. Then it's like any other sale. Your gain of $17,000 is taxable as $16,000 ordinary income and $1,000 capital gain.

Trade-ins generally follow the same pattern, but here there is normally no recognized gain to worry about.

Example: Adjusted basis of old machine is $10,000, value $20,000. You trade it in for a new machine costing $50,000, paying $30,000 cash. Your post-1961 depreciation deductions were $5,000.

Result: Adjusted basis of new machine is $40,000—$10,000 carryover basis plus $30,000 cash. It carries over a section 1245 potential of $5,000 from the old machine.

Corporate dividends and liquidations.—They're caught in the new web, too. If a corporation distributes section 1245 property to stockholders—as a dividend, in redemption of stock, or in complete or partial liquidation—there'll be a tax to the corporation on the section 1245 potential just as if it had sold.

Tax-free liquidations will be tax free no longer. The 12-month liquidation under section 337, the 1-month liquidation under section 333, and the Kimbell-Diamond liquidation of a subsidiary—all are caught. There's just one exception—liquidation of a subsidiary under section 332 where the parent carries over the subsidiary's basis.

However, transfers to the corporation on initial incorporation or as contribution to capital—will not invoke section 1245 treatment, except up to the amount of any gain recognized; the corporation carries over section 1245 potential.

Partnership transactions are also hit.—A partner will realize his share of the section 1245 income when he sells his interest. If his interest is completely or partially liquidated, he'll realize income if he doesn't receive his share of the section 1245 potential; the other partners will realize income if the outgoing partner receives more than his share.

What property's covered?—Section 1245 property is roughly the same as property which qualifies for the new investment credit. That is, it must be depreciable, but buildings and their structural components are excluded. It also includes tangible real properties, such as blast furnaces and pipelines, which are not buildings or structural components and which are used in manufacturing, production, extraction, transportation, communication, and public utilities, or which are research or storage facilities for these activities. But it goes even further and includes intangibles, such as patents, and assets with a useful life under 4 years.

Effective date.—Recapture hits sales and other dispositions after date of enactment. Consider these two points:

(1) If you have section 1245 property with pre-1962 appreciation in value, it may be better to sell it before post-1961 depreciation deductions pile up. Reason: Each dollar of such deductions will turn the appreciation into a dollar of ordinary income if you sell later on. Furthermore, your replacement property may qualify you for a tax saving via the proposed investment credit.

(2) Still don't be panicked into selling before enactment. Any time in 1962 is just as good. Reason: Section 1245 reaches only depreciation deductions for tax years beginning after January 1, 1962. But on a sale any time in 1962, IRS would get the same result by d[illegible]ving your depreciation deduction for the year of sale. It doesn't need section 1245 to do this (Cohn, CA-6, 259 F. 2d 371).

More freedom on salvage values.—But the news isn't all bad—the bill liberalizes present depreciation rules in one way: It lets businessmen disregard salvage by up to 10 percent of original cost on personal property with a useful life of at least 3 years. So, if a machine costs $10,000 and has a salvage value of $1,500, you will be able to reduce salvage to as little as $500 ($1,500 minus $1,000). That means you can then deduct $9,500 over the years instead of $8,500.

You get this break only on property you buy after enactment.

Progress report

Last Monday, the Senate Finance Committee began 5 weeks of hearings on the House-passed bill. The administration wants to tighten things up. For example, it wants to bring buildings under the depreciation recapture provisions. Opponents are especially critical of the investment credit.

STOCKHOLDER-OFFICER MISSES OUT ON DEDUCTION WHEN HE PAYS BACK TOO-HIGH SALARY

Executives Berger and Kelling owned the stock of real estate corporation which paid them excessive salaries. A revenue agent cut them down by one-third each. Result: The company lost its deduction for the excess, while they paid a tax on it.

Resourceful Mr. Berger and Mr. Kelling repaid the excess, and claimed a deduction on their personal returns. Now that we're restoring this, they said, we should get a deduction for what we repaid.

The fallacy? This, said the Tax Court: Nobody can compel a stockholder to return excess salary. There's no deduction if your repayment is voluntary (Berger, 37 T.C. No. 101).

Not long ago a stockholder rented a building to his company. IRS said the rent was too high and disallowed half. He paid back the disallowed part, but (like Berger and Kelling) he couldn't deduct his repayment either (Simon, 281 F. 2d 520, 6 AFTR 2d 5274).

Is there a way out?

Here's one possibility, though it hasn't been tested in court: Make a reimbursement agreement before you get any salary. This gives you the argument that you were legally obligated to pay back. Actually the Tax Court might ignore this too, especially if it's the controlling stockholders who are in on the salary and repayment deals.

Compare this.—Suppose only one of the stockholders—say he owns 40 percent—repays. He should get a deduction; at least the Tax Court allowed it in one case (Clark, 11 T.C. 672; see also Wetstone, D.C. Conn., 5 AFTR 2d 1486).

Impairment of capital.—Suppose the excess salary puts the stock under water. Under State law the company may have a strong legal duty to get it back. One early case gave the shareholders relief in this situation (Eakins, D.C. N.Y., 36 F. 2d 961, 8 AFTR 9931).

Higher stock basis and refund

Assuming IRS wins, there's this consolation prize—what you repay is a contribution to the company's capital, and increases the basis for your stock.

Moreover, you should claim a refund for the earlier year. Ground: The excess should be treated as a dividend, so you're entitled to the 4 percent credit and $50 exclusion.

PROFIT-SHARING EXTRA—DISTRIBUTIONS TO COVER MEDICAL EXPENSES ARE TAX FREE

Qualified profit-sharing plans—long a tax favorite with companies and employees alike—can now boast of an attractive new feature. In a private letter ruling, IRS has just given the go-ahead signal to one west coast company to reimburse its employees for medical expenses through tax-free profit-sharing distributions (letter ruling, February 20, 1962).

Why tax free?—Most profit-sharing distributions are taxable to the recipients—some as ordinary income, some capital gain. But section 105(b) says that amounts you receive as accident or health benefits—for example, reimbursement for medical bills of you, your spouse, or dependents—aren't taxable. And the regulations say section 105 applies to distributions under a profit-sharing plan (regulations sec. 1.72–15).

Tax-free cycle

Follow it from deductible beginning to tax-free end: Employer deducts his contribution; employee isn't taxed when the contribution is made; the trust's earnings are tax exempt; and, to the extent the distributions are paid out to reimburse participants for medical expenses, they're tax free.

How your employees benefit.—They profit in two ways. First, there's financial protection against the sky-high costs of a medical emergency. Second, there's a substantial dollar saving—even for your low-bracket employees. How? Since the entire distribution will be tax free, employees will now recover 100 cents on their medical dollar; they'll be able to bypass the maximum and minimum limitations which the tax law places on medical deductions.

What to do

Test the water before jumping in. This is a complicated area of the tax law, so don't take chances. If you're interested, ask your tax adviser to get you your own ruling from the Revenue Service. And if you'd like to see the groundbreaking private letter ruling, it's at paragraph 54,708 of the 1962 P-H Federal Tax Service.

GOOD NEWS FOR CONTRACTORS WHO REPORT ON THE COMPLETED CONTRACT METHOD

The nice thing about the completed contract method of accounting is that you don't report any income until you're all through with the job and the work's been accepted. Of course, IRS may try to limit this break. It can claim that a contractor isn't entitled to use the completed contract method. Or, though

it concedes this method is proper, it may argue that the contractor still should have reported income sooner than he did. The Revenue Service did make these arguments in two recent cases, but the taxpayer came out on top both times.

Have you a cost-plus contract?—The Sam Emerson Co. did And it elected to report on a completed contract basis. But IRS objected. It argued that since profits were tied to costs, the company knew at the end of each year how it made out.

The completed contract method is OK for cost-plus contracts, said the Tax Court. It's a standard accounting method. And what's more, since Emerson Co. was potentially liable for its negligence, it couldn't determine its overall profit until the entire contract was completed and accepted (Sam Emerson Co., 37 T.C. No. 107).

Was your final certificate delayed?—That's what happened to Thompson-King-Tate, Inc. The company finished its work under a long-term construction contract in 1953, and was paid most of the money due it. However, the architect's final certificate of completion was held up until 1955. IRS thought the completed contract method required the company to report income in 1953.

No tax until 1955, said the sixth circuit, backing the company. Reason: The regulations require final completion and acceptance of the contractor's work before the income is taxed (regulation section 1.451-3(b)(2)). Substantial completion isn't enough (Thompson-King-Tate, Inc., 8 AFTR 2d 5920, rev'g 6 AFTR 2d 5455).

THE DOORKEY TO DEDUCTING HIGH SALARIES—THE PAST PLUS THE RECORD

Recently we discussed a case in which the chief executive and controlling shareholder of a company received a $32,000 bonus on top of his $18,000 salary. Even though IRS tried to cut down his company's deduction, the Court of Claims thought he was worth the money and allowed it in full (Gordy Tire, 8 AFTR 2d 5876).

Here's another taxpayer victory. This company head's salary was strictly contingent; if the company did well, he did well.

Ziegler and Glendale were equal owners of Steel Corp. Ziegler contributed the know-how and services; Glendale the cash. Ziegler's salary was 20 percent of net profits and in 1956 and 1957 came to almost $250,000. IRS disallowed half.

Full deduction allowed (Ziegler Steel, TC memo 1962-57). Why? Even though it's large and wholly contingent, it's reasonable because:

(1) The salary payments to Ziegler were made under a contract entered into 10 years before.

(2) It was an arm's-length agreement.

(3) Over the past 10 years Ziegler's salary ranged from $45,000 to $150,000.

(4) The corporation's success was due in large measure to Ziegler's ability.

Comment

Generally, the Tax Court is very strict on a contingent salary setup, especially to a stockholder. But Ziegler shows that you don't have to be afraid if you've got a good case and take the trouble to prove it.

YOU DON'T NEED INCOME TO DEDUCT UPKEEP EXPENSE OF INCOME-PRODUCING PROPERTY

You've often read that the cost of maintaining income-producing property is deductible. That's true as far as it goes. But a recent case reminds us that upkeep and depreciation can be deducted even though no income is actually produced.

Mr. Drown bought the Marion Davies home in Santa Monica, intending to turn it into a beach club. He spent $23,000 the first year on upkeep and repairs. Depreciation was $5,000. What can he deduct?

The whole thing, says a district court. You can deduct the expense of maintaining property held for rental or investment though it produces no income in the tax year (Drown, 9 AFTR 2d 989).

Tip for homeowners

Many homeowners can benefit from this same rule. If you move out of your house and put it up for rent, you can take a deducton for maintenance and depreciation although you never take a penny in rentals.

MUST THE SURVIVOR OF A MERGER CARRY ON BOTH PREMERGER BUSINESSES?

No, it's a tax-free shuffle, says a District Court.

Take this common situation. Warehouse Corp. merges with Manufacturing Corp. Warehouse shareholders don't expect to pay a tax on the Manufacturing stock they receive; they have scrupulously followed one of the code-approved patterns for a tax-free reorganization [sec. 368]. Suppose Manufacturing converts the storage space into a new plant. The regulations under section 368 say that "continuity of the business enterprise" is an essential ingredient of a reorganization. Will discontinuance of Warehouse's business result in tax on the transaction? No, said a district court recently.

In the case before it, the court was considering the merger of a real estate subdivision company into in insurance company. The insurance company held the real estate as part of its required reserves. But this change in business use didn't bother the court. The survivor must carry on a business, but it doesn't have to be the same as or similar to the premerger business (Bentsen, D.C. Tex., 9 AFTR 2d 2685).

Other courts have reached the same conclusion. What makes this case interesting? Previously it was the taxpayer who made the argument in order to escape the reorganization provisions. Here it was the Government that for the first time pressed for this version of the "continuity of business enterprise" requirement.

What was in IRS mind?—Presumably it thought the deal looked more like a sale than a reorganization. Why? Because it felt the survivor of the merger was after its predecessor's assets, not its business. Taxmen feel IRS may try to apply the "continuity" requirement as restrictively as possible.

Things to come.—There are already indications IRS is taking a harder line in related areas. It will no longer issue advance rulings on the merger of a personal holding company into a publicly held investment company or on the transfer of securities to a mutual fund on incorporation. And if IRS does try to tax personal holding company mergers, it will find some support in the *Bentsen* case. Although the same business doesn't have to go on, the court indicates that there must be some business which can be continued. The activities of incorporated pocketbooks would ordinarily not be extensive enough to constitute a business.

RECAPTURE OF DEPRECIATION

Basis weaknesses of House bill in respect to partnership distributions, and effects on carryover of section 1245 potential. Basis aspects of gift transfers; effect of gift tax on basis

In a partnership distribution, the distributee partner does not necessarily receive a carryover basis. Although carryover of the partnership's basis is the "pattern" rule of section 732(a), there are numerous instances where this is not true.

Thus, suppose the basis of the distributee partner's interest is $75,000, and he receives a distribution of $20,000 cash, inventory with a basis to the partnership of $20,000, and depreciable property with a basis to the partnership of $50,000. The cash and inventory take a carryover basis of $40,000, reducing the basis of the partner's interest to $35,000, and the depreciable property takes a basis of $35,000 (reducing basis of his interest to zero). Here the distributee partner has a basis lower than the partnership's.

Again suppose basis of a partner's interest is $100,000, and he receives in liquidation of his interest depreciable property on which the partnership's basis is $85,000. The partner's basis for the distributed property is $100,000. Here his basis is higher than the partnership's.

The House bill meets this problem after a fashion by adding the partnership's section 1245 potential at time of distribution to the distributee partner's new basis, whatever it is, to determine the property's recomputed basis in his hands. The example in the committee report supposes basis to partnership $85,000, basis to distributee partner $75,000, and section 1245 potential carried over of $15,000. Thus although the partnership's recomputed basis was $85,000 plus $15,000, the distributee partner's recomputed basis under the House bill will be $75,000 plus $15,000. He sells for $103,000 without taking further deductions and has section 1245 gain of $15,000. The result is sound here, but not the procedure.

I. The procedure reaches an unsound result in many cases, as shown by this variation, where the distributee partner's basis is higher than the partnership's. Suppose the distributee partner's basis for his interest had been $100,0000 instead of $75,000. Then on liquidation of his interest, the property would have a basis in his hands of $100,000—he could sell at this point and wipe out all section 1245 potential. To give him a "recomputed basis" of $115,000, as the House bill does, is meaningless because there will probably be no gain on sale.

This, then, becomes a very convenient escape hatch from section 1245 treatment.

In other words, section 1245 operates only when there is gain. Here there is none.

The trouble could be removed by providing that for purposes of determining the amount of gain to which section 1245(a)(1) applies, the adjusted basis (at time of sale or disposition) of the distributee partner shall be reduced by the amount by which his basis after distribution exceeded the adjusted basis to the partnership before distribution. Of course, an appropriate capital loss would have to be provided.

Example: On our assumed facts, gain (for sec. 1245 purposes) would be computed as $100,000 amount realized minue $85,000 (= $100,00, basis at sale minus $15,000 difference between basis to distributee partner at distribution and basis to partnership at distribution). However, for purposes of determining gain under section 1001(a), gain is $100,000, amount realized, minus $100,000 basis, or 0. In addition, there is a $15,000 capital loss.

The reason why the $15,000 compensating loss is not taken into account as an adjustment to basis in competing section 1001(a) gain or loss is that this would produce a section 1231 loss ($100,000 amount realized minus $115,000 basis), and so offset the section 1245(a)(1) gain in many cases. Essentially, however, the loss is from liquidation of a partnership interest, so should be treated as capital.

If the suggestion above is adopted it will be necessary to provide for a reduction in the recomputed basis by the same amount as the reduction in the recomputed basis by the same amount as the reduction in adjusted basis for purposes of computing section 1245 gain. For example, on our facts recomputed basis would be reduced from $115,000 to $100,000. So, if the distributee partner sold for $105,000 instead of $100,000, he would have $15,000 section 1245 gain, $5,000 section 1231 gain, and $15,000 capital loss.

It is entirely possible that, in some cases, the procedure above will produce a negative basis for purposes of computing section 1245 gain. For example, on our assumed facts, if the distributee partner takes $100,000 of depreciation deductions and then sells the property for $5,000, his adjusted basis for section 1245 computation purposes is minus $15,000 and his recomputed basis is 0. He therefore has $15,000 section 1245 income, $5,000 section 1231 gain, and a $15,000 capital loss.

In this connection, note that *Parker* v. *Delaney*, (186 F. 2d 455 (1st Cir., 1950)) held that abandonment is a "disposition."

II. Conversely, where the partner's adjusted basis is less than the partnership's, an injustice may be done under the House bill.

Example: Assume adjusted basis to partnership of $85,000, with section 1245 potential of $15,000. Assume the distributee partner's basis for the property is $50,000. He sells the property (without taking further depreciation) for $85,000.

The proper result here is that no section 1245 income should be realized. Yet under the House bill the partner's recomputed basis would be $65,000; section 1245 income would be $15,000. Again the result is fortuitous, depending on the accident that adjusted basis to the distributee is not the same as it was to the partnership.

Conclusion: For purposes of determining the amount of gain on which section 1245 operates, adjusted basis (at time of sale or disposition) should be increased by the amount by which the distributee partner's basis after distribution is less than the adjusted basis to the partnership.

Example: On the facts above, adjusted basis for purposes of section 1245 would be $85,000 ($50,000 plus $35,000 difference between basis on liquidation). Thus there is no gain for section 1245 purposes. For section 1001(a) purposes, the gain is $35,000. It may be further desirable to treat $10,000 of this as capital gain and the balance as section 1231 gain.

As in corresponding point I above, recomputed basis would be increased by the same amount. For example, on our facts, recomputed basis would be in-

creased to $100,000 ($50,000 adjusted basis plus $15,000 depreciation added back plus $35,000 special adjustment).

III. Similarly, in a transfer by gift the House bill as drafted may reach more gain than it properly should, because of the fact that the donee's carryover basis is increased by the amount of gift tax paid (sec. 1015(d)).

Example: Father owns section 1245 property; value $150,000, adjusted basis $90,000, and post 1961 depreciation deductions of $50,000. He gives to son and pays a gift tax of $25,000.

Son's adjusted basis is $115,000 ($90,000 plus $25,000). His recomputed basis under the House bill is $165,000 ($115,000 plus $50,000). However, the recomputed basis should stop at $150,000. If son sells for $165,000, the $15,000 gain realized above $150,000 should be treated as capital gain, as it would be to father if he retained the property.

There is no indication in the House committee report of an intention to penalize transfers of section 1245 property by gift. On the contrary, it seems evident the intention was to put son in the same position father would have been had father retained the property. The effect of gift tax on son's recomputed basis appears to be an oversight. The result of the House bill, however, makes the property in son's hands less desirable than in the hands of father, since the first $15,000 accretion in value would be ordinary income if realized by son, whereas it would have been capital gain if realized by father. Thus the House bill result may affirmatively discourage gifts of section 1245 property.

Recapture of Depreciation

Liquidation of deceased partner's interest—income in respect of a decedent effects of House bill on death-value basis

If a partnership owns section 1245 property, the House bill—section 14(e)—says that the amount of gain which would be section 1245 gain to the partnership will be an "unrealized receivable" for purposes of section 736, among others.

When a partner dies, the partnership often buy his interest from his estate or heirs. In fact buy-out agreements for this purpose are common. The normal tax results are shown by an example:

P is a one-third partner. At death, the partnership owns unrealized receivables of $15,000 and other partnership property of $30,000. Total $45,000. Value of the estate's interest is $15,000. Its basis for the interest, however, is only $10,000. Reason: $5,000 of the $15,000 value at death is attributable to unrealized receivables, which are rights to income in respect of a decedent (regulation sec. 1.742–1, relying on IRC, sec. 1014(c)).

Suppose the partnership pays the estate $15,000 in liquidation of the deceased partner's interest. The mechanics of the statute treat $5,000 of this as ordinary income. It is reasoned as follows: Under section 751(b)(1)(B), there is an imputed distribution to the estate of its share of the receivables ($5,000). There is then an imputed sale of the receivables to the partnership for $5,000 cash. On this sale, the successor realizes $5,000 ordinary income, since the basis of the receivables in his hands is zero. (Note sec. 732(d) does not give a stepped-up basis for the receivables here.) This is followed by a distribution of $10,000 cash to the estate, having no tax consequences because its basis is also $10,000.

There is no way of escaping recognition of income on the $5,000. Under section 736, all payments arrtibutable to unrealized receivables must be treated as section 736(a) payments. And, under section 753, all section 736(a) payments are income in respect of a decedent.

This is fine in the case of true unrealized receivables. But it is wholly inappropriate to the fictitious section 1245 receivables created by the House bill. They really represent only appreciation in value of depreciable property. If owned outright by the decedent (instead of in partnership), his estate would have, under the House bill, a stepped-up basis. The estate would not be taxed with income or carry over the deceased's section 1245 potential. The same should be true on liquidation of a deceased partner's interest.

Probably the result reached in the House bill is unintended and a drafting oversight. (However, see p. 70 of House committee report for possible indication the problem received some thought.)

RECAPTURE OF DEPRECIATION

Liquidation of partnership interests; appropriateness of using section 751 to achieve result desired

The House bill does not cover current distributions of section 1245 property at all, as pointed out in a companion memorandum on that subject. Its answer to liquidating distributions is to treat them under the collapsible partnership rules of section 751.

It is suggested that section 751 is not an appropriate vehicle for treating partnership distributions of section 1245 property. The fundamental objective here is to prevent shifts of section 1245 income or potential from outgoing partner to partnership and vice versa. The House committee report evinces confidence that the House bill accomplishes this. Does it?

Turn to example (3) of the regulations under section 751. It illustrates what might be called the section 751 melting-pot concept. All section 751 items are thrown together and any distribution of section 751 items up to an outgoing partner's share is treated as outside section 751. Only the excess (or deficiency) of section 751 items is treated as within section 751.

For example, if, as in example (3), equal partnership ABC has:

$9,000 accounts receivable, basis	$9,000
$30,000 inventory, basis	21,000
Total ($39,000)	30,000

and partner C retires, section 751 does not operate to the extent ABC distributes any $13,000 of section 751 items to C. Thus, in example (3) the distribution is of $13,000 inventory, consisting of C's $10,000 share and $3,000 treated as exchanged for $3,000 of account receivable.[1]

The regulation says the exchange of $3,000 inventory for $3,000 accounts receivable is not within section 751. The net effect is that the profit on the $3,000 of inventory which C receives in excess of his share of inventory is shifted from the partnership to C.

Another way of looking at it is this: Before distribution, each partner had $3,000 of potential ordinary income on section 751 items. After distribution, C has potential ordinary income of $3,900 (value $13,000, basis $9,100), while A and B each have potential ordinary income of $2,550 (value $8,500 each, basis $5,950).

Conversely, C can be gotten out of the partnership with less than his share of the ordinary income potential. Suppose, for example, the distribution to C is $9,000 accounts receivable and $4,000 inventory.[2] In this case C carries over only $1,200 of potential ordinary income ($4,000 value of inventory minus $2,800 basis). Some $1,800 of potential income is shifted to the partnership.

The same kind of maneuvering will be possible with section 1245 "unrealized receivables" if section 751 is used to handle partnership distributions. For example, suppose partnership ABC has the following assets:

	Basis	Value
Sec. 1245 property	$8,500	$10,000
Inventory	900	1,500
Accounts receivable	1,500	1,500
Cash	5,000	5,000

NOTE.—No liabilities.

[1] In example (3), there is a further inventory distribution of $7,000, for a total of $20,000. The regulation treats the $7,000 as an excess distribution under sec. 751(b), on which, accordingly, gain is recognized.

[2] Plus, of course, other property necessary to bring the entire distribution up to the value of his interest.

For section 751 purposes this would presumably be rearranged as follows:

	Basis	Value	Potential income
Sec. 1245 receivable	0	$1,500	$1,500
Inventory	900	1,500	600
Accounts receivable	1,500	1,500	0
Sec. 1245 property	8,500	8,500	
Cash	5,000	5,000	
Total		18,000	2,100

Partner C withdraws, receiving $1,500 of accounts receivable and $4,500 cash. Because C has received his share of section 751 items, section 751 does not apply—and C does not carry over any section 1245 potential. It has all been shifted to A and B.

It seems that quite erratic results may be reached under section 751. In view of this, it would appear preferable to deal with section 1245 problems in liquidating partnership interests entirely separate and apart from similar problems with inventory and unrealized receivables. This could be done by an entirely new section of the code or by a new subsection added to section 751. The gist of it would be that on distributions in liquidation or partial liquidation of a partnership interest, the outgoing partner realizes income to the extent he receives less than his share of section 1245 potential, and the partnership realizes income to the extent he receives more than his share.

RECAPTURE OF DEPRECIATION

Current distributions by partnerships

The House bill proposes to treat distributions of section 1245 property by a partnership to a partner under the collapsible partnership rules of section 751. These rules apply, however, only on complete or partial liquidation of a partner's interest. They do not apply to current distributions (Reg. sec. 1.751-1 (b)(1)(ii)).

To a certain extent, this is already a loophole in the treatment of items presently encompassed under section 751. For example, suppose a partnership of Father & Son. Father has a great deal of income and is in a high bracket; Son in a low bracket. The share of each in current earnings is $10,000 and the firm has $10,000 of fees earned but not yet paid. Father is paid $10,000 in cash but Son gets the receivables. Result: Father's income is his distributive share, $10,000; it would have been $15,000 if the firm had collected. Son's income is $20,000; it would have been $15,000 if the firm had collected. Thus $5,000 of income has been shifted from Father's return to Son's, without substantial economic difference.

In a mercantile business, this can be done by current distributions of appreciated inventory.

Under the House bill, the same is possible in the case of section 1245 property. By current distributions of section 1245 property, the section 1245 potential can be taken out of the partnership and thus out of the returns of high-bracket partners. If a partnership is going to sell property with a section 1245 potential anyway, why not make a current distribution of it to the partner in whose return the income (when realized on sale) will do the least harm?

This seems wrong. A much preferable approach would be to follow the pattern which the House bill sets for corporate dividends. There, a current distribtuion creates Section 1245 income to the corporation.

As applied to partnerships, where the distributee partner's share of the gain should not be taxed unless and until realized by sale or other disposition, that means:

The partnership would realize section 1245 income to the extent section 1245 potential distributed to any partner during the year exceeds his pro rata share of the total section 1245 potential distributed. This section 1245 income should be specially allocated to the distributive shares of income of partners receiving less than their pro rata shares. A simple example illustrates the principle:

Example: A, B, and C are each one-third partners. In a current distribution to A, the partnership distributes a section 1245 asset with value of $10,000 and a

post-1961 depreciation deduction account of $1,500, of which, therefore, each partner's share is $500.

Since B and C have now escaped the possibility of section 1245 taxation on the asset, the partnership should be considered as having sold B and C's share ($1,000) of the section 1245 potential distributed. The profit on this sale ($1,000) should be specially allocated to B and C under section 702(a), and the basis of the asset on distribution should be increased by $1,000.

If there are several current distributions of section 1245 property during the year, the same technique can be applied to the deficiency in section 1245 potential received by a partner below his pro rata share of the total.

Example: A receives property with $1,500 section 1245 potential, B property with $1,000 potential, and C property with $500 potential. The total section 1245 potential distributed in current distributions is $3,000 and the share of each partner is $1,000.

This can be treated as if the partnership sold $500 of section 1245 potential, the profit on which is allocated to C. Basis of property distributed to A would be in creased by $500.

Of course, at present current distributions of unrealized receivables and appreciated inventory do not come under the collapsible rules of section 751. Where true unrealized receivables are distributed, as in the father-son example above, the Revenue Service might possibly deal with it on an assignment of income theory. See *Jud Plumbing*, 5th Cir., 153 F. 2d 681, and *Williamson*, Court of Claims, 292 F. 2d 524, for cases supporting the assignment theory or its equivalent in a corporate setting. The keystone to Government success here is the fact that income had already been earned and was not taxable to the partnership only because its method of accounting hadn't included it yet.

But it seems impossible to maintain an assignment of income position as to appreciated but unsold inventory; even less as to the fictitious section 1245 receivables created by the House bill. No income has been earned yet; in the section 1245 property case, sale of such property normally doesn't recur frequently in the course of business, so looks even less like an assignment of income.

It is a fair reading of the House committee report that the House bill draftsmen thought they had included current distributions. See committee report, page 70. If so, this objective has surely not been achieved. Further, it should be noted that different criteria should govern current and liquidating distributions. In liquidating distributions, the question is: Has the outgoing partner received his share of the total section 1245 potential of the partnership? In current distributions, however, the question should be: Has the outgoing partner received currently more section 1245 potential than other partners have received currently?

Recapture of Depreciation

Collapsibility of partnerships and effect of House bill on definition of substantially appreciated inventory

The collapsible partnership rules are in section 751 of the code. Normally, a partner gets capital gain on sale or liquidation of his interest. But under the collapsible rules the outgoing partner (1) is always taxed at ordinary income rates on his share of the unrealized receivables, (2) is taxed at ordinary income rates on his share of the potential profit from inventory but only if all "inventory items" have "substantially appreciated in value."

The term "inventory items" is defined very broadly by section 751(d), so broadly that the section 1245 potential of the partnership—made into an "unrealized receivable" by the House bill—might be dragged into the definition, with unintended consequences. "Inventory items" include not only property held for sale to customers, but also (sec. 751(d)(2)(B)) "any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in section 1231."

The regulations say this does include both realized and unrealized receivables (Reg. sec. 1.751-1(d)(2)(ii)). Furthermore, section 1245(a) of the House bill says that, on sale or other disposition of section 1245 property, the section 1245 gain "shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231."

An excellent argument could be made, therefore, that the section 1245 unrealized receivable created by the House bill is an "inventory item" within the meaning of section 751(d). Whether this argument is conclusive is beside the

point. It is there and it is troublesome. What is the practical effect if it is accepted?

True inventory—property held for sale to customers—is not subject to collapsible treatment unless "inventory items" as a whole have "substantially appreciated." They have "substantially appreciated" only when their value is greater than (*a*) 120 percent of the adjusted basis to the partnership and (*b*) 10 percent of the value of all partnership property, other than money (sec. 751(d)).

Notice that adding section 1245 receivables to value increases that side of the equation, in some cases perhaps immensely. However, nothing is added to the other side. The 120-percent figure is not increased because the basis of section 1245 receivables is presumably zero. The 10-percent figure is not increased because the value of all partnership property remains the same.

Thus, the net result would or could be that many partnerships not collapsible today will be collapsible under the House bill, insofar as true inventory is concerned.

Of course, this possibility should be obviated before enactment.

RECAPTURE OF DEPRECIATION

Failure of House bill to provide reduction in carryover of section 1245 potential after recognition of gain in carryover basis and similar cases

Generally, when property is transferred and carries over its pretransfer basis, the House bill provides for carryover of the pretransfer section 1245 potential. More exactly, under section 1245(a)(2), post-1961 depreciation deductions of the transferor (as well as of the transferee) are added to the transferee's adjusted basis in figuring recomputed basis of the transferee.

Under the House bill, a similar principle applies to carryover bases in like kind exchanges and involuntary conversions.[3]

But no provision clearly covers the case where section 1245 recognizes gain on the transaction. That some provision should be made is best shown by this example:

Business machinery with an adjusted basis of $100,000 is destroyed in a fire. Insurance proceeds are $117,000 and post-1961 depreciation deductions were $16,000. Under the involuntary conversion privileges of section 1033, the owner replaces with similar property costing $114,000.

Gain recognized is $117,000 (amount realized) minus $114,000 (cost of replacement) or $3,000. This will be taxed as section 1245 income under the House bill.

Under section 1033(c) new basis=cost of new—gain not recognized.

But gain not recognized in turn = cost of new minus adjusted basis of old.

Substituting—

New basis equals cost of new minus (cost of new minus adjusted basis of old)
cost of new minus cost of new plus adjusted basis of old
adjusted basis of old

It seems, then, that within the meaning of section 1245(a)(2), the new basis "reflects" the entire $16,000 of post-1961 depreciation deductions taken on the old property. So if owner now sells for $117,000 without further depreciation deduction, he will have a section 1245 gain of $16,000 (plus capital gain of $1,000).

Yet the correct result clearly is that only $13,000 should be added on to the basis of the new property in figuring its recomputed basis—$3,000 of the carried-over section 1245 potential has already been realized.

It is possible to argue that, since $3,000 of gain was recognized, only $13,000 of post-1961 depreciation deductions are still "reflected" in adjusted basis, within the meaning of section 1245(a)(2). But this seems a strained interpretation. It is more natural to say that depreciation deductions are "reflected" in adjusted basis whenever they enter the equation which determines that basis. Here they enter through the adjusted basis of the old property.

Moreover, what ground is there to atribute the $3,000 of recognized gain to post-1961 depreciation deductions? It could as righly be attributed to pre-1961 deductions, or partly to each.

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[3] Technically, in involuntary conversions, the replacement property does not have a carryover basis (Reg. sec. 1.1033(c)-1(b)). But, as demonstrated above in this memorandum, basis of the old property is "reflected" in basis of the new within the meaning of sec. 1245(a)(2).

The same point arises, of course, whenever section 1245 property has a carry-over basis. (Contributions to corporations or partnerships, sec. 1031 exchanges, etc.)

Some provision should be made to clarify the point before enactment. In substance, post-1961 depreciation deductions carried over should be reduced by the amount of the gain recognized and taxable under section 1245.

Example: As above, insurance proceeds $117,000; adjusted basis $100,000; cost of replacement property $114,000; gain recognized $3,000. However, post-1961 depreciation deductions at time gain is recognized are only $1,000.

Although section 1033 recognizes $3,000 gain here, only $1,000 of the gain is attributable to post-1961 depreciation deductions and taxable under section 1245, and this should be the amount of reduction in section 1245 potential carried over. It would be wrong to reduce the potential by the entire $3,000.

Recapture of Depreciation

Section 333 liquidation of corporation; earnings and profits and subchapter S corporations aspects of House bill

Under the House bill, a "one-month" section 333 liquidation of a corporation is treated the same for section 1245 purposes as any other corporate liquidation. That is, the corporation realizes section 1245 income as if it had sold its section 1245 property at the moment of liquidation. The earnings and profits are accordingly increased by the section 1245 gain (minus tax attributable to it).

The theory behind the way the House bill treats normal corporate liquidations is that the company may have underpaid its tax through excessive depreciation deductions; to recoup the underpaid tax and restore it at the corporate level, the tax is imposed at time of liquidation.

However, for section 333 liquidations, this treatment results in far more drastic tax burdens on stockholders than in normal liquidation. This is so because, under section 333, the individual stockholders must take in their ratable shares of earnings and profits as a dividend, taxable at ordinary income rates.

Moreover, this treatment produces inequality of result as between normal and section 333 liquidations. It will result in two successive ordinary income taxes, whereas in the normal liqudation there will be one ordinary income tax on the corporation and a capital gain tax on the stockholder.

Particularly for subchapter S corporations is this unfortunate.[4] It should be possible for small business to achieve the benefits (such as limited liability) of operating in corporate form and still be taxed as partnerships. Congress recognized this in enacting subchapter S, which substantially parallels partnership treatment for current operations and distributions.

Even on liquidation, it is now possible through section 333 to achieve substantially partnership-type treatment for subchapter S corporations (and others). In fact, the basic idea behind section 333 is that it is like a partnership liquidation. The salient similarities are : (*a*) Gain is not generally recognized in either case (except as to money in excess of basis in a partnership liquidation, and as to money and certain securities in a sec. 333 liquidation). (*b*) Both section 333 stockholders and partners take over the assets of the enterprise at the adjusted bases of their stock or interests.

The one principal point of difference actually carries out the analogy further. The difference is that partners do not generally realize income from liquidation, while section 333 stockholders may be taxed with a dividend on their share of the entity's earnings and profits. This is accounted for by the fact that the partner was currently taxed on his share of the entity's earnings, while the stockholder was not. Thus the stockholder is doing all at once what the partner has been doing over a period of time.

In effect, the House bill throws a substantial obstacle into this desirable feature of the tax law. It will probably make section 333 liquidations unusable whenever there is substantial section 1245 potential. Stockholders will rarely go through with section 333 liquidations if there is a large dividend tax in store, and the House bill guarantees just that.

There are several ways of handling this problem, any one of which would improve the House bill.

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[4] Technically in subch. S corporations, gain on liquidation will increase the stockholders' distributive shares of corporate earnings, rather than the corporate earnings and profit account itself. The effect is much the same.

Proposal 1. Recognize section 1245 gain to the corporation, but don't add it to earnings and profits. On the corporate level, this will achieve parity with normal liquidations. And as to the stockholder, it is consistent with the basic nonrecognition purpose of section 333, since it does not add anything to the amount of income recognized to him.

Proposal 2. Recognize section 1245 gain and add it to earnings and profits, but tax this part of a stockholder's share of earnings and profits as capital gain. That achieves exact parity with normal liquidations both on corporate and stockholder levels. But it adds to the tax on the stockholder, and thus is less consistent with the fundamental purpose of section 333.

Example: Post 1961 depreciation deductions of $16,000 on corporate section 1245 property; adjusted basis $100,000 and fair market value $117,000. Under the House bill as well as under both proposals 1 and 2 above, the corporation realizes $16,000 section 1245 income. Assume tax on the section 1245 income is $6,000.

Under proposal 1, nothing is added to earnings and profits. There is no added tax to the stockholders.

Under proposal 2, earnings and profits are increased $10,000. Assume $40,000 earnings and profits apart from the section 1245 income on liquidation, or total earnings and profits of $50,000. Assume also the stockholder's gain is $100,000. Then $10,000 is taxable as capital gain and $40,000 as a dividend. (The $60,000 balance is not recognized under section 333, except as to money and certain securities.) If the stockholder's gain had been only $25,000, then ten thousand fifty-thousandths of it, or $5,000, should be capital gain. Forty thousand fifty-thousandths, or $20,000 should be dividend.

Under the House bill, earnings and profits are increased $10,000, and (assuming gain of at least $10,000) the entire $50,000 is taxed as a dividend to stockholders.

Proposal 3. Give full-scale partnership-type treatment to the section 1245 gain, either for all corporations or for subchapter S corporations only, with other corporations treated under proposals 1 or 2.

Following the partnership analogy as it appears in the House bill this means (1) no tax to the entity on its section 1245 potential at time of liquidation, (2) except to the extent that a distributee receives more or less than his share of section 1245 potential and (3) carryover of the entity's section 1245 potential to the distributee.

The special problem of a section 333 liquidation not present in partnerships is that, in effect, it is two liquidations because "qualified electing shareholders" are treated specially and all others in the regular way. That suggests the following treatment:

(*a*) Recognize and tax to the corporation that part of the section 1245 potential proportionate to the interests of those who are not qualified electing shareholders. If one-fifth don't qualify, one-fifth of the gain will be taxable per se. The amount normally added to earnings and profits (gain minus tax on the gain) should not be added in this case, since it would only increase taxes on qualifying stockholders.

(*b*) In addition, recognize and tax to the corporation any part of the section 1245 potential attributable to the interests of qualifying stockholders as a group which is not in fact distributed to them. For example, assume four-fifths is their share, but that two-fifths is distributed to nonqualifying stockholders. Since one-fifth of qualifying stockholders' potential has been shifted to the nonqualifying group, one-fifth should be taxed to the corporation. The appropriate addition to earning and profits should be made and allocated entirely to the account of qualifying stockholders as a group.

(*c*) As to the remainder of the section 1245 potential, to the extent a particular qualifying stockholder receives less than his share (vis-a-vis other qualifying stockholders), the corporation realizes section 1245 income. The appropriate addition to earnings and profits is allocated entirely to that stockholder's share of earnings and profits.

In practice, most cases shouldn't involve the maximum complications possible under proposal 3 above. Because of limitations built into section 333, most section 333 liquidations are of corporations in modest businesses owned by small cohesive groups of stockholders; presumably all are normally qualified electing shareholders. Most of the time, therefore, the proposal outlined above will not entail more complication than the House bill already entails for liquidation of partnerships.

To the extent section 1245 potential is not realized by the corporation in a section 333 liquidation, it would be carried over to qualifying stockholders in the manner prescribed under the House bill for partnership liquidations.

If proposal 3 is confined to subchapter S corporations, a special problem is created by the fact that the corporation can switch from subchapter S status and back. Obviously, it would be inappropriate to allow a nonsubchapter S corporation to become one in contemplation of liquidation.

A solution is to divide the section 1245 potential into a part attributable to subchapter S years and a part attributable to nonsubscriber S years. The part attributable to nonsubchapter S years would be automatically taxable; the part attributable to subchapter S years would be treated as outlined in proposal 3.

More specifically: Under section 1245(a)(1), if fair market value at liquidation is above recomputed basis, the section 1245 potential equals total post-1961 depreciation deductions on the section 1245 assets; and the amount of section 1245 potential to be treated as outlined in proposal 3 would simply equal post-1961 deductions attributable to subchapter S years. The rest would be treated as nonsubchapter S years' potential. But if fair market value at liquidation is below recomputed basis, then under section 1245(a) the section 1245 potential (on corporate liquidations) is only the difference between fair market value and adjusted basis; in that case the part attributable to nonsubchapter S years would bear the same proportion to total section 1245 potential as post-1961 deductions in nonsubchapter S years bear to total post-1961 deductions.

There are, of course, basis allocation differences between section 333 liquidations and partnership liquidations. Under section 333, basis of a shareholder's stock is allocated among assets received substantially according to the relative values of the assets at liquidation. (See regulation, sec. 1.334-2.) In partnership liquidations, on the other hand, basis of a partner's interest is allocated among assets received in proportion to their adjusted basis to the partnership (apart from cash, receivables, and inventory, which are not sec. 1245 assets anyway).

RECAPTURE OF DEPRECIATION

Weaknesses in House bill definition of "personal property" and of "depreciable property"; intangibles included

The definition of "section 1245 property" is none too clear under the House bill. Specifically, it should be stated whether "property subject to the allowance for depreciation provided in section 167" includes property subject to amortization. And it should be stated whether "personal property" includes possessory interests in (a) land, (b) buildings and structural components, and (c) the fixture-type assets specified in section 1245(a)(3)(B).

In adition, the question arises whether the inclusion of all intangibles as section 1245 property does not go too far.

I. The regulations draw a sharp distinction between amortization and depreciation. For example, a tenant who buys a leasehold interest in land amortizes the cost over the remaining term of the lease as a business expense under section 162; he does not take depreciation deductions under section 167. (See regulation sec. 1.162-11(a).) Likewise, a tenant erecting a building under a long-term lease amortizes the cost over the life of the lease if the useful life of the building is longer than the term; but if it is less than or equal to the term of the lease, his deduction is for depreciation. (See regulation, sec. 1.162-11(b) and regulation, sec. 1.167(a)-4.)

There is at least one practical difference between amortization and depreciation. Amortization is always a straight line writeoff, while depreciation may be eligible for accelerated methods.

Nevertheless, a recent Tax Court case (*Baker*, 38 TC No. 2) holds that property of a character subject to the allowance for depreciation provided in section 167 includes property subject to amortization. The case arose because the identical phrase appears in section 1239, and the Government successfully argued, in spite of the regulations, that there is no difference between depreciation and amortization within the meaning of the language quoted.

Thus it seems better to provide explicitly either for "depreciation (but not amortization)" or for "depreciation (or amortization in lieu of depreciation)." Actually, it would seem that the latter makes more sense, particularly in connection with the fixture-type interests included as section 1245 property under section 1245(a)(3)(B).

To illustrate, consider the case of a taxpayer who puts fixtures (not a building or structural components) on property. If he owns the property and the fixtures outright, the fixtures are depreciable and clearly section 1245 property as defined in the House bill. But if he does not own the property and instead has it under a lease which will expire before the useful life of the fixtures and either the fixtures aren't removable under the lease or it would be impracticable to remove them, the writeoff is through amortization.

For example, a friend of mine rented space for a dance studio and put paneling on the walls to give it atmosphere. The paneling will far outlast the lease. It would be useless on removal and he does not plan to remove it. Instead he is writing it off over the term of the lease. Another example is where a tenant constructs a building on leased land, and in connection with this puts in fixture-type property (not structural components) such as blast furnaces or counters, not removable at lease's end. (See case 3 below.)

II. Turning to the concept of "personal property," it is impossible to ascertain the intention of the House bill as to leases of land and buildings. The committee report says without qualification that personal property includes intangibles; that indicates inclusion. Furthermore, leases have been classed as personal property by the common law for centuries. On the other hand, section 1245 as drafted excludes buildings and structural components, which looks the other way.

On balance, it seems probable a court would hold that leases are personal property within the meaning of section 1245 of the House bill and (if we accept the premise that depreciable property includes property subject to amortization, that they are section 1245 property.

The question is of practical importance. Not only are long-term leases bought and sold frequently, but corporations or partnerships in liquidation may distribute leases to the stockholders. The following cases should be considered.

1. Tenant leases land and pays advance rent. He amortizes the advance payment over the lease term. Midway in the term, he assigns the lease for value.

Does his gain come within section 1245? Under the House bill, apparently it does—his lease is personal property and it is property of a character subject to an allowance for depreciation (amortization).

2. Tenant leases land. Later he assigns the lease for a consideration and the new tenant amortizes the cost over the remaining life of the lease. He in turn sells at a gain. Does the second tenant's gain come within section 1245? Apparently it does under the House bill.

3. Tenant leases land and constructs building which has a useful life longer than the term of the lease. He amortizes the cost over the term of the lease (regulation sec. 1.162–11(b)). Later he sells the lease for more than his adjusted basis. Apparently this gain also comes within sec. 1245 of the House bill.

(Notice: In constructing the building, the tenant will also probably put in fixture-type assets which are sec. 1245 property by virtue of sec. 1245(a)(3)(B). A problem arises as to how gain attributable to these is to be treated. See point I above.)

4. Same as 3, except that the second tenant assigns the lease to a third tenant after amortizing part of his cost. Does the second tenant's gain come within section 1245? Apparently.

5. Same as 3, except that the life of the building is shorter than the term of the lease. Tenant depreciates the cost of the building over its useful life (regulation sec. 1.167(a)–4). Before end of the building's useful life, tenant assigns the lease for a consideration greater than his adjusted basis. The gain is due to both (1) appreciation in rental value of the land; and (2) appreciation in value of the building caused by higher contemporary construction costs.

An excellent argument can be made that both elements of the gain are within section 1245. As to the land, see cases 1 and 2 above. As to the building, tenant's interest is personal property (assuming that technically landlord owns the building because affixed to the realty) and it is subject to depreciation. It comes literally within the statute as drafted.

In all of these cases, the source of the gain is essentially increase in value of land, building, or both; or in case 5 the source could, indeed, be attributable to excessive depreciation deductions because of accelerated methods, too short a useful life, or underestimated salvage. The point is that the real estate people persuaded the House Ways and Means Committee to exempt real estate from section 1245. The results reached above are inconsistent with that exemption.

III. The third point is what intangibles should be included in section 1245 property. This raises the question, what is the fundamental purpose of section 1245.

The House committee report represents the purpose as primarily reform. It states that excessive depreciation deductions may have been taken against ordinary income because of underestimated useful lives, underestimated salvage, or accelerated methods (committee report, pp. 66-67). It is also true, of course, that gain on resale may be due to inflationary factors—and this is a speculative, investment-type element that should be entitled to capital gain. However, in practice it is impossible to distinguish between the sources and the House approach is to attribute all gain to overdepreciation.

It may well be doubted that the premise is correct. Indications are that useful lives permitted by the Revenue Service have been grossly overstated for years. In fact, the Treasury conceded this in prescribing much shorter useful lives for the textile industry and in announcing a complete revision of bulletin F. On the other hand, it is known that reproduction costs have risen greatly. Thus it would appear that the Government has actually been getting a break on depreciation deductions, and that gains on resale are due, by and large, to inflation.

Consequently, it is hard to take at face value the protestations of the House committee report. The one legitimate argument—that the gain may be attributable to overdepreciation because of accelerated methods—is easily answered by taxing as a recapture of depreciation only the excess of accelerated depreciation over what would have been deducted under the straight line method.

But whatever the merits of the "reform" argument, it does not apply to writeoffs of intangibles. If intangibles, such as patents, can be written off at all, they must have a definitely limited useful life. There is no estimation involved and no salvage value.[6] And only tangible property may be written off under double-declining or sum-of-the-years-digits accelerated methods (conceivably a patent can be written off under the 150 percent declining balance method).

Likewise, the "reform" reasoning does not apply to amortization writeoffs. If a tenant erects a building with a useful life greater than the term of his lease, the period of writeoff is definitely fixed; it is not subject to estimation and there is no salvage. Furthermore, amortization is always a straightline writeoff, so there cannot be overdepreciation through accelerated methods.

It is possible that section 1245 is being tied in with useful life revision. The House committee report so intimates. That might justify it if the businessman is really going to be given leeway in choosing useful lives. However, one doubts that revenue agents will really do this or that the revised Bulletin F will really prescribe useful lives that are on the short side. Probably nothing short of a statute prohibiting disturbance of any reasonable useful life chosen by the taxpayer would really do the trick. But whatever the merits, if this is the underlying objective, neither intangibles nor amortization writeoffs come within it, since there is no leeway in either case to choose a too short useful life.

One suspects that the real reason behind section 1245 is simply to raise revenue. If this is so, inclusion of intangibles and of amortization writeoffs may be justified. It should be noted, however, that property benefiting from the investment credit—tangible personal property—will then not be perfectly matched by property bearing the burden of new taxation—tangible and intangible personal property.

Mutual Savings Banks

Amount of distribution in redemption or partial liquidation chargeable to earnings and profits to reserve accounts under House bill

In the House bill, new section 593(f) provides an order of priority for the corporate accounts against which distributions to stockholders are to be charged. These rules govern current dividends, redemptions, partial and complete liquidations. The order provided for dividends is (*a*) accumulated earnings and profits; (*b*) reserve for losses on real property loans; (*c*) supplemental loss reserve; and (*d*) other appropriate accounts. For redemptions and partial and complete liquidations, the general scheme is the same with a different order of priority.

The House bill appears to contemplate and direct charging of the entire amount of the distribution against these accounts. This is too favorable to stockholders. A point apparently overlooked in the drafting of section 593(f) is the rule of the *Jarvis* case (49 BTA 439; aff'd, 4th Cir., 123 F. 2d 742), as explained in

[6] It is possible that patents and copyrights may be written off in some cases over a period shorter than the maximum useful life. But these must be rare cases, requiring strong proof that the actual period of usefulness is shorter.

G.C.M. 23460 (1942-2 Cum. Bull., p. 190). This rule appears in recondite form in section 312(e) today.

Briefly, under present law, on a distribution in redemption or partial liquidation, only part of the distribution is charged to earnings and profits. Part is charged to capital account, thus does not reduce future liability of stockholders to dividend treatment.

Appropriate clarification of this point should be made before enactment.

Brief on Manufactured Tobacco—Chewing, Smoking, and Snuff

(Submitted by Mr. W. Brooks George, Larus & Bros. Co., Inc., Richmond, Va.)

The manufactured tobacco (chewing, smoking, and snuff) segment of the tobacco industry is in a very distressed condition. After carefully weighing all of the aspects of this problem it is apparent that it can only be resolved by reduction in the Federal excise tax rate on manufactured tobacco.

From 1862, when tax was first imposed on tobacco products, until 1918, when manufactured tobacco attained its peak of production in the United States, such tobacco represented an important part of the significant contribution of the tobacco industry to the economy of this country. Since 1918, however, there has been a steady decline in the production and consumption of manufactured tobacco in the United States.

In 1918 more than 400 million pounds of manufactured tobacco were produced in more than 1,500 factories in this country. The Federal Government collected more than $50 million in revenue from its exercise tax on manufactured tobacco, which represented about one-third of the total Federal tobacco tax collections in 1918. On the other hand, in 1960, the last year for which complete figures are now available, only 173 million pounds of manufactured tobacco were produced. The number of tobacco factories in business dropped to less than 175. The Federal Government collected only $17 million in the fiscal year ended June 30, 1961, from its excise tax on manufactured tobacco. That amount represented less than 1 percent of the total Federal tobacco tax collections in 1961.

According to statistics released by the U.S. Department of Agriculture, and Health, Education, and Welfare, 75 percent of all consumers of chewing and smoking tobacco live in rural areas. Particularly striking is the fact that 65 percent of the consumers have incomes under $3,000 per year. It is also striking that 85 percent of such consumers receive less than $1,000 per year. Therefore, manufactured tobacco is basically a poorman's tobacco, since the bulk of the consumers thereof are persons with low income. Accordingly, the cost of such tobacco to consumers must be held to the lowest figure possible. Manufacturers have consistently attempted to do so by improving production, packaging, and distribution methods, passing on to the consumer the benefits of improved efficiency. This has been done despite increased costs of the leaf or raw tobacco, labor, packaging, and marketing of manufactured tobacco.

As a result of the steady and drastic decline in the consumption of manufactured tobacco, coupled with mounting increases in manufacturing and marketing costs, producers of such tobacco have been hard pressed for many years in their efforts to stay in business and to provide quality merchandise to low-income consumers at a price such consumers can afford to pay. On November 1, 1951, the Congress reduced the Federal excise tax on manufactured tobacco from 18 cents to 10 cents per pound in an effort to alleviate the problem and to stimulate this long established and important segment of the tobacco industry. However, the production and consumption of manufactured tobacco continued in steady decline. A drop of 20 percent occurred from 1951 to 1961. Therefore, it is now imperative that the existing Federal excise tax on manufactured tobacco be reduced from 10 cents to not more than 4 cents per pound. Such tax reduction is essential in order to stabilize and revitalize such tobacco.

THE NATIONAL BOARD OF FIRE UNDERWRITERS,
New York, N.Y., April 11, 1962.

Re Section 13 of H.R. 10650.

Hon. HARRY F. BYRD,
Chairman, Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The Association of Casualty and Surety Companies and the National Board of Fire Underwriters have no objection to the elimination of the tax haven operation proposed under section 13 of H.R. 10650. However, the bill as drafted not only eliminates the insurance tax haven, but also eliminates tax deferral on normal foreign subsidiary operations, thereby placing U.S.-owned foreign insurance operations at a disadvantage with foreign-owned competitors in seeking their fair share of the foreign insurance market. A committee representing American insurance operations in the worldwide market has drafted the attached memorandum and proposed amendments to section 13 of the bill, which are directed solely to resolving this problem.

The American insurance market in recent years has been expanding its worldwide operations and hopes to continue this progress in the future. While few of our member companies now own foreign domiciled subsidiaries, the normal growth pattern for this worldwide operation will, most certainly, result in an increase in the number of such companies organized or bought during the next few years.

In order to maintain the continued growth of American insurance in the worldwide market, we urge that section 13 of the bill be modified in its application to insurance and reinsurance written by American-owned foreign insurance companies in line with the proposed amendments submitted herewith, for the reasons set forth in the attached memorandum.

Respectfully submitted.

ASSOCIATION OF CASUALTY & SURETY COMPANIES,
ROBERT N. GILMORE, Jr.,
General Counsel.
NATIONAL BOARD OF FIRE UNDERWRITERS,
J. RAYMOND BERRY,
General Counsel.

DETAILED EXPLANATION

CONTROLLED FOREIGN CORPORATIONS

We urge that section 13 of the bill be modified in its application to insurance and reinsurance written by American-owned foreign insurance companies.

The report of the House Ways and Means Committee (page 57) states:

"In this area the President recommended the: '* * * elimination of the tax haven device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance, and others, that typically seek out tax haven methods of operation. There is no valid reason to permit their remaining untaxed regardless of the country in which they are located.'

"Your committee's bill does not go as far as the President's recommendations. It does not eliminate tax deferral in the case of operating businesses owned by Americans which are located in the economically developed countries of the world. Testimony in hearings before your committee suggested that the location of investments in these countries is an important factor in stimulating American exports to the same areas. Moreover, it appeared that to impose the U.S. tax currently on the U.S. shareholders of American-owned businesses operating abroad would place such firms at a disadvantage with other firms located in the same areas not subject to U.S. tax."

We express no opposition to the quoted objectives. However, in eliminating the insurance tax haven, H.R. 10650 has gone so far that it defeats the expressed purpose of preserving tax deferral of operating insurance businesses abroad owned by American insurers.

INSURANCE ABROAD

American insurers do not have a share of the foreign insurance market commensurate with the size and strength of our insurance industry. International

reinsurance, for example, is almost completely dominated by European-owned concerns. In direct insurance, a few American concerns have sizable foreign operations, but they are not large in the worldwide scene. American insurers should be encouraged to participate in foreign business. And to get business, we have to go after it.

To date most American companies operating abroad have done so by the branch office method. But foreign domiciled subsidiaries have been used in some cases and are contemplated in others. This alternative method of expansion should not be discouraged. Section 13 as presently drafted forecloses the subsidiary method of acquiring bonafide foreign business.

In many cases the subsidiary route is the better, or only, method of foreign expansion because:

(1) Certain countries have local requirements that effectively prohibit the branch office approach. Growing nationalism indicates the number of such countries will increase.

(2) The branch method does not permit local minority participation.

(3) Occasionally it is possible to acquire a going foreign concern by purchase of a controlling stock interest.

HOW SECTION 13 WOULD OPERATE ON INSURANCE AND REINSURANCE OF AMERICAN RISKS

Section 952(b)(1) makes immediately taxable under subpart F, income in respect to any insurance or reinsurance of U.S. risks. This presupposes that every single piece of U.S. insurance business that finds its way to an American-owned foreign insurer goes there for tax-avoidance purposes.

This is not so. First, an American parent insurer or reinsurer may utilize reinsurance in a foreign subsidiary simply to cut down its own exposure to adverse underwriting results. Normal contracts on the same basis that the parent reinsures business with nonowned companies, American or foreign, should not be penalized.

Second, a foreign operating subsidiary by its own sales activities will undoubtedly be offered participations in American risks by way of reinsurance cessions which originally found their way to the foreign reinsurance market through regular channels, completely separate from the parent and from tax-saving motives.

Such routine business would be a small portion of the overall volume of a bona fide foreign operating insurance subsidiary. Its existence should not compel either a departure from the usual pattern of tax deferral nor should the company and its owners be compelled to compute income and keep books on the U.S. basis in addition to the basis required by local accounting and local regulation.

In contrast, in the so-called insurance tax haven device, what is typically encountered is an American-controlled foreign insurer without sales or underwriting or claim personnel, or a principal office worthy of the name, the vast mojority of whose business represents controlled business on American exposures shuttled to the foreign company in one way or another by the American parent.

Prior releases by the Ways and Means Committee indicated that the bill would deal with the latter situation and not the former. But H.R. 10650 does not preserve the distinction.

We, therefore, recommend reverting to an approach limited to immediate taxation of income from specific tax haven transactions. A more desirable alternative, however, particularly from the standpoint of ease of administration and certainly of result, would be an amendment excluding from subpart F income, any income from insurance or reinsurance of U.S. risks if no more than 20 percent of the total net premium writings of the controlled foreign insurance corporation was on U.S. risks.

We also wish to point out that the definition of U.S. business as that in connection with residents of the United States produces what we believe is an unintended result in that it might be construed to include insurance on foreign properties owned by, or foreign activities of, U.S. concerns. This should be clarified.

Is foreign business U.S. business?

Proposed section 952(b)(2)(B) goes so far as to classify certain insurance and reinsurance of wholly foreign exposures as U.S. business where the foreign business results from an exchange of U.S. business of comparable premium volume. This attempt to get at a hypothetical evasion goes too far.

BEST AVAILABLE COPY

It ignores the realities of European reinsurance. European insurers reinsure a much larger proportion of their total writings than do American companies. When they reinsure, particularly on proportionate business, they customarily demand—and they receive—approximately equal amounts of reinsurance cessions back. This is their standard method of preserving volume while spreading the risk.

Thus, an American-owned company starting in Europe today, if it expects to get any start at all is going to have to offer other business in exchange. This business must initially be retrocessions of American business obtained from the parent for the simple reason that that is all it has available for reciprocity purposes. There are no tax considerations involved.

We recommend, therefore, that section 952(b)(2)(B) be eliminated, or amended so it applies only to transactions not in the ordinary course of business and not for tax purposes.

INVESTMENT INCOME

Proposed section 952(e)(1) includes as "Foreign base company income" investment income of a controlled foreign corporation. In this regard the report of the Ways and Means Committee stated (p. 62):

"Your committee while recognizing the need to maintain active American business operations abroad on an equal competitive footing with other operating businesses in the same foreign countries, nevertheless sees no need to maintain deferral of U.S. tax where the investments are portfolio types of investment income. In such cases there is no competitive problem justifying postponement of the tax until income is repatriated.

"The passive income referred to here is the same as 'foreign personal holding company income except that rental income is included whether or not rents represented more than 50 percent of the gross income involved. An exception is also made for income of banks and bank subsidiary organizations since in such cases the receipt of interest and other similar types of income do not result from passive investments."

The investment income of an insurance company, just as in the case of a bank, does not result from passive investment. An insurer's working capital, and its reserves must be actively invested. Accordingly, we recommend the addition of another paragraph similar to the banking exception (952(e)(5)) exempting from the definition of "foreign base company income" the income of any corporation organized and actively doing a substantial non-U.S. insurance business under the laws of a foreign country. To prevent use of a dormant foreign insurer for investment holdings, the exclusion is limited to concerns which maintain complete foreign offices and a minimum number of full-time employees located at such offices who are actively engaged in insurance sales, underwriting, or claim activities.

The possibility of "passive" investment income through deliberate retention of earnings by way of excessive surplus is provided for by proposed section 951(a)(1)(B) taxing earnings invested in nonqualified property.

INVESTMENT IN NONQUALIFIED PROPERTY

Proposed section 951(a)(1)(B) would tax to a 10 percent or greater shareholder of a controlled foreign corporation the increase in earnings invested each year in "nonqualified" property. Qualified property, in general, is property situated outside the United States which is ordinary and necessary for the active conduct of a "qualified trade or business," i.e., the same trade or business which the controlled foreign corporation was carrying on on December 31, 1962, or during the 5-year period ending with the close of the preceding taxable year, or a new or unrelated trade or business carried on in a less developed country. There are a few stated exceptions to the rule that qualified property must be situated outside the United States, notably, U.S. Government obligations and bank deposits.

Because of the special nature of insurance it is essential that companies carrying on a bona fide insurance business be excepted from these investment restrictions. The investment portfolio of an insurance company is ordinary and necessary for the active conduct of its business. An insurance company must select its investments according to the tests of safety and adequate yield. In the case of life insurance it has a special fiduciary obligation to safeguard the long-term savings of its policyowners. In many countries of the world, as in the United States, the company is subject to governmental regulation, enforced by local

insurance commissioners, as to the investments it may make. The proposed bill would superimpose additional restrictions which have no relation to the proper standards by which insurance company investments are selected. On the contrary, these restrictions largely frustrate a sound investment policy. They would penalize a controlled foreign insurance company for investing in the securities of U.S. corporations. Companies commencing business after December 31, 1962, would be restricted to investment in "less developed" countries regardless of whether the investment opportunities in such countries were adequate or suitable. Whatever the merits of directing through the pressure of tax policy ordinary private investment toward less developed countries, it is wholly unsound to impose such restrictions on insurance companies which deal with their policyowners' money—especially when the policyowners are in most cases foreign nationals.

Another effect of these provisions would be to prevent a controlled foreign insurance corporation from writing contracts of insurance and reinsurance payable in U.S. dollars. An insurance company must invest its reserve assets in the same currency as its contract liability, or at least in as sound a currency. It cannot gamble on exchange fluctuations and controls. U.S. Government obligations and bank deposits alone are not satisfactory investments, particularly for life insurance companies, since the yield is too low to allow the company its required investment earnings if it is to offer rates competitive with those offered by foreign companies. The writing of U.S. dollars insurance and reinsurance should not be confused with the question of whether or not the risk is located in the United States. There is a substantial amount of U.S. dollar business available in the international insurance market simply because for one reason or another insureds prefer dollar contracts to those expressed payable in other currencies. Controlled foreign corporations should not be prevented from competing with their foreign competitors in writing such business. Furthermore, whether premium income is derived from U.S. or, in most cases, foreign nationals, its investment in U.S. securities can only benefit this country's balance-of-payments position.

Therefore, it is urged that proposed section 953(b)(2) be amended to permit controlled foreign insurance companies doing a bona fide insurance business to invest their policy reserves and a reasonable allowance of surplus freely and without regard to the restrictions presently in the bill. Without this investment freedom, U.S.-owned companies now in business will not be able to compete with foreign companies and new companies will not be organized.

NO LOSS CARRYBACK OR CARRY-FORWARD

As we read the bill, a U.S. insurance company conducting its foreign operations through a foreign subsidiary would be in a substantially worse tax position than one operating on a branch basis.

Thus, if a foreign subsidiary operation were consistently unprofitable over a number of years, the parent could not use such losses to offset profits on domestic business.

Where there are two or more foreign subsidiaries, a loss in one could not be offset against profits of another subsidiary.

Proposed section 951 speaks of each taxable year separately. While calculations of subpart F income on insurance on U.S. risks in a fire and casualty company is supposed to be made under the methods prescribed by subchapter L, it is by no means clear whether the loss carryback and carry-forward provisions apply. How does what one would term a "subpart F loss" get the prompt tax recognition accorded to subpart F income? As we read the bill, in years a foreign subsidiary profits on U.S. business, the parent is promptly taxed as if the business were written by the parent, but in the years when a loss results there is neither carryback, nor carry-forward against subpart F income of other years, nor any offset against subpart F income of other subsidiaries nor against profits of the parent.

We recommend that an appropriate provision be added so that the parent may elect to be taxed on the income of a particular subsidiary in the same manner as it would have been, had the operation been conducted as a branch.

SUMMARY

These amendments are urgently needed. Othewise U.S. insurers will find themselves at a serious competitive disadvantage with local competitors on foreign business. Indeed, as to reinsurance the present bill would have even given foreign-owned companies a competitive advantage over a U.S.-owned foreign subsidiary on American business.

1. Amend S. 952(b)(1) (A) and (B), defining income from insurance of U.S. risks to read:

"(A) Against loss or damage to, or legal liability in connection with property, or upon the lives or health of persons, in the United States or

"(B) Against loss or damage to, or legal liability in connection with property, or upon the lives or health of persons, not in the United States as the result of any arrangement, not in the usual course of an insurance or reinsurance business, whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of any reinsurance or the issuing of any insurance or annuity contract in connection with property in, or residents of, the United States, and the principal purpose of such arrangement is to secure the benefit of a reduction of income otherwise taxable as provided in this section."

2. Amend S. 954(b) defining controlled foreign corporations to read:

"(b) SPECIAL RULE FOR INSURANCE. For purposes only of taking into account income described in section 952(a)(1)(A) (relating to income derived from insurance of U.S. risks), the term "controlled foreign corporation" includes:

"(1) a foreign corporation as defined by subsection (a) provided the gross amount of premiums or other considerations in respect of insurance or reinsurance of U.S. risks (as defined in section 952(b)(1) (A) and (B) exceeds 30 per centum of the gross amount of all premiums or other consideration in respect of all risks; and

"(2) a foreign corporation of which more than 25 per centum of the total combined voting power of all classes of stock is owned, directly or indirectly (within the meaning of section 955(b)), by United States persons on any day during the taxable year of such corporation if the gross amount of premiums or other consideration in respect of insurance or reinsurance of United States risks (as defined in section 952(b)(1) (A) and (B) exceeds 75 per centum of the gross amount of all premiums or other consideration in respect of all risks."

3. Amend section 952(e)(5) to read:

"(5) INCOME OF CERTAIN BANKS AND BANK-CONTROLLED CORPORATIONS AND CERTAIN INSURANCE CORPORATIONS EXCLUDED. The term 'foreign base company income' does not include—

"(A) [No change.]

"(B) [No change.]

"(C) the income of any foreign corporation organized and actively doing a substantial insurance or reinsurance business outside of the United States under the laws of a foreign country. A corporation shall be considered to be 'doing a substantial insurance or reinsurance business outside of the United States' if

"(i) it maintains a foreign office in which it is the principal occupant and

"(ii) it has a staff of at least five employees engaged full time in the sale, underwriting or claim adjustment of insurance or reinsurance contracts and

"(iii) the gross amount of premiums or other considerations in respect of insurance or reinsurance of United States risks (as defined in section 952(b)(1) (A) and (B)) does not exceed 30 per centum of the gross amount of all premiums or other considerations in respect of all risks."

4. Amend section 958(b)(2) defining qualified property by adding (E) to read:

"(E) any property wherever located held by a controlled foreign insurance corporation as assets to meet its matured and contingent liabilities under insurance, annuity and reinsurance contracts, in an amount required in the ordinary and necessary conduct of its business."

THE NATIONAL BOARD OF FIRE UNDERWRITERS,
New York, April 11, 1962.

Hon. HARRY F. BYRD,
Chairman, Finance Committee, U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: This memorandum is submitted on behalf of the Association of Casualty & Surety Cos. and the National Board of Fire Underwriters, for the purpose of outlining the position of these organizations with respect to section 10 of H.R. 10650, which relates to the taxation of mutual and reciprocal insurance companies.

The membership of the National Board and the association consists solely of stock insurance companies writing fire and casualty lines of business. Our combined membership in 1959 wrote 48 percent of all fire and casualty business and 68 percent of all fire, inland marine, and allied fire lines of business written by all classes of insurers in the United States. Our member companies have always been taxed on their total income, as are other business corporations.

Our position on the taxation of insurers other than life, may be summarized as follows:

(1) We believe in the principle of equality of taxation.

(2) We believe that all such insurers should be taxed on their total income as are other business corporations.

(3) Accordingly, we favor the retention of the total income method of taxation of stock insurers and believe that nonstock insurers should be taxed in that manner.

(4) We are opposed to section 10 of H.R. 10650, because it is inconsistent with the foregoing.

(5) We are opposed to the special privileges which nonstock insurers would gain under that bill and do not seek them for stock insurers.

PROTECTION AGAINST LOSS (PAL) ACCOUNT

We are opposed to those provisions of section 10 of H.R. 10650 which provide for the establishment and maintenance by mutual and reciprocal fire and casualty insurers of a special "protection against loss" (PAL) account to which annual tax-free transfers of income would be made. Under these provisions, a portion of such contributions to the PAL account would become taxable after 5 years. However, another portion of income—12½ percent of underwriting gain—would remain in the PAL account forever in the case of a company which is consistently successful. Accordingly, it would appear that the larger the company and the more profitable its operations, the more it would gain from this provision while, on the other hand, this provision would be less beneficial to smaller companies.

These provisions, we submit, defeat section 10's primary purpose which is to achieve tax equality between mutual and reciprocal insurers and stock insurers, in accordance with the President's message on taxation of April 20, 1961. In fact, these provisions, far from eliminating an equality, would actually create tax advantages for mutual and reciprocal insurers.

Special tax treatment would be afforded these insurers on the ground that it is necessary to give "recognition to the mutuals' lack of access to the capital market for funds with which to pay losses" (H. Rept. 1447, Ways and Means Committee, p. 48). We submit that lack of access to the capital market is not a proper element of consideration in the development of income tax legislation. We also disagree with the contention that mutual insurers should be permitted to accumulate tax-free funds to insure their health, to finance their growth, and to maintain their competitive position. This is particularly pertinent when we consider that during the 5-year period ending December 31, 1960, mutual companies have been able to increase their surplus 40.8 percent (as compared with an increase in the combined capital and surplus of stock companies of 30.8 percent), and to increase their premium writings 60.8 percent (as compared with an increase in premium writings by stock companies of 48.6 percent). Another consideration in this connection is the fact that a reduction in dividend payments to policyholders equal to 1 percent of earned premiums would provide mutual companies with more than the funds needed "as an important protection to the mutual policyholders."

Furthermore, the capital market is available to stock companies only when investors can be assured of a sound security with a favorable outlook for future earnings. It is totally unrealistic to think in terms of an available

capital market as a source for providing funds to take care of losses. The plain fact of the matter is that all insurers today, whether stock, mutual, or reciprocal, must rely on their ability to add to their surplus from current underwriting and investment income, if they are to continue to meet the rapidly growing demands of the insuring public. No segment of the insurance business should be given a special tax advantage to meet the risks common to all insurers.

The claim is made that, "while a stock insurance company can pay extraordinary losses not only out of its accumulated profits, but out of its paid-in capital, a mutual insurance company can pay extraordinary losses only out of retained underwriting income" (H. Rept. 1447, Ways and Means Committee, p. 42). In this connection it should be noted that the payment of extraordinary losses by mutual companies is not limited to underwriting income. As in the case of stock companies, such losses may be paid out of all of the accumulated profits, whether these profits are from retained underwriting income or investment income. Furthermore, mutual companies can retain for such purposes all or any portion of the large amounts usually paid to policyholders as dividends.

In accordance with the stated position of our member companies, we are opposed to any permanent deferral of taxable income of nonstock insurers. However, we would have no objection to the inclusion of such a provision for a "loss protective account," as was provided in the "discussion draft" bill previously prepared by the House Ways and Means Committee which would be limited to one 5-year period, plus an additional 5-year period during which the account would run off into income. This would be in the nature of a transition provision, which would expire at the end of the 10-year period.

In conclusion, we quote with approval from the statement made by Secretary of the Treasury Dillon to the Senate Finance Committee on April 2, 1962, as follows:

"The 5-year deferral provision is continuous in its effect; taxation of each succeeding year's underwriting gain is deferred for 5 years. Thus it is more than a mere transition to regular corporate taxation. If the growth trend of the mutual companies continues, each successive year's underwriting gains will exceed the gains of the fifth preceding year, so that current full taxation will never be achieved. In addition, permanent deferral of one-eighth of underwriting gains is a windfall for the most profitable companies; only those companies with consistent underwriting profits will be able to enjoy this permanent deferral and the larger their profits the greater the value of the benefit.

"The House provisions represent an important step toward placing the mutual fire and casualty insurance companies on a tax basis which recognizes underwriting as well as investment sources of income or loss. But the regular corporate basis of taxation, as originally recommended by the President, and as now applied to the stock companies would provide simpler and more equitable treatment. In effect, this recommendation would eliminate both the 5-year and permanent deferral provisions of the House bill."

For the foregoing reasons, we urge the elimination from H.R. 10650 of the provisions relating to the protection against loss (PAL) account and all proposed tax-free transfers to such account.

Respectfully submitted.

Association of Casualty & Surety Companies,
Robert N. Gilmore, Jr., *General Counsel.*
National Board of Fire Underwriters,
J. Raymond Berry, *General Counsel.*

Farmers Casualty Co., Mutual,
Des Moines, Iowa, April 10, 1962.

Hon. Harry Flood Byrd,
Senate Office Building, Washington, D.C.

Honorable Senator: Before this week is over you will be hearing claims from stock and mutual companies, on the merits and demerits of this proposal included in section 10 of H.R. 10650.

I would like for you think on this purpose: to raise more money is the basic reason. Are you sure you want to forgo the main purpose until 1968? I don't believe there will be additional revenue until that time, under this bill. In place of increased revenue you will be confronted with less revenue.

The sources of income of most companies are premiums and investments. The simplicity of uniform tax would be welcome by all companies, however, in this proposal and those in the past will always be construed as unfair and the loudest protestor will gain advantage, not on facts but on noise. Why not look at the last 3 years of income tax paid? Note, they will say this is an unreliable time. So it may be, the proposal calls for only a 3-year rollback; therefore, I felt obliged to accept the time element of the bill, to determine who pays the most tax per income dollar.

The figures from "Best's Aggregate and Averages," a stock publication, shows that stocks in 1959, for each $196.96 income, paid $1 income tax. The mutuals paid $1 income tax on each $98.62 of income. In 1960 the stocks paid $1 income tax on each $143.22 of income. The mutuals paid $1 income tax on each $94.70 of income. This clearly shows mutuals are paying more than their share.

The hodgepodge of language of this section 10 of H.R. 10650 create suspicions as to how this will be interpreted. The Treasury Department already shows hostility to this law.

We could make this very simple to police and regulate by requiring all insurance companies to pay 1 percent of the total income reflected in a notarized annual statement. Tax to be based on total direct premiums written and net investment income.

I believe this proposal is somewhat like the one we have now, but the cost of policing and collection would be negligible.

I am afraid someone has laid a smokescreen of words to you and have completely hid the facts from you. This bill will produce less tax from mutuals until 1967 or 1968. It will still hide the fact that mutuals pay more tax per dollar of income than any other group of insurance companies, at least for the last 3 years as provided in the period of rollback of this bill.

We trust you are fair and want all companies taxed proportional to their income. I will be at the Congressional Hotel, care of Doliver Kent, Jr.

Yours truly,

GEORGE BOWLES, *Secretary-Treasurer.*

ATLANTIC MUTUAL INSURANCE CO.,
New York, N.Y., April 11, 1962.

Re Mutual Marine Insurance Cos.; section 10(e), revenue bill of 1962 (H.R. 10650).

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

MY DEAR SENATOR BYRD: We would like to request an amendment of section 10(e) of H.R. 10650 as it passed the House in order to clarify the intent of the Congress with respect to the years from 1954 to 1961.

The insertion of section 10(e) entitled "Election of certain mutual companies to be taxed on total income" followed a request by us for clarification of existing law which since 1942 has provided that mutual marine insurance companies be taxed in the same manner and at the same rates as stock, fire, and casualty companies.

The Atlantic Mutual Insurance Co., to our knowledge, is the only mutual marine insurance company which has filed its Federal income tax returns under the provisions of section 831, and its predecessor in the 1939 code, since the enactment of that section. However, the fact that during the past decade fire and casualty insurance written by the Atlantic Mutual has been increasing more rapidly than marine insurance has made the company's status as a mutual marine company not entirely clear. Because (1) the marine business by nature is one of extreme fluctuations, (2) the company has a wholly owned stock subsidiary taxable under section 831, and (3) all of the principal competitors of the Atlantic Mutual Insurance Co. are stock companies, the company wishes to continue to be taxed under section 831 in the same manner and at the same rates as stock companies. It takes this position notwithstanding the possibility that, as pointed out by Secretary Dillon in his recent appearance before your committee, it might be foregoing some future advantage in the form of lower taxes which it might derive by being taxed as a mutual fire and casualty company under the provisions of section 821.

Section 10(e) of the House bill which provides an election by a mutual company without regard to the predominance of marine insurance as a source of premium income would cure this problem for 1962 and future years. However, the problem still remains for all prior years which have not yet been closed. In order to avoid any doubt on the point, the company requests that the intent of Congress be made clear by making the election provided for in section 10(e) become effective as of January 1, 1954, instead of January 1, 1962. The section could provide that the earlier effective date of the election would apply only if the electing company had filed timely returns for the years 1954 to 1961 inclusive (taking into account extensions of time), as a mutual marine company under section 831. Thus the use of the earlier date would not be retroactive in a true sense; it would merely serve to clarify and be in lieu of a definition of "mutual marine insurance company."

A pattern and precedent are present in the Technical Amendments Act of 1958 which made numerous amendments of a technical nature retroactive to 1954. The legislation here proposed is in the nature of a technical amendment; it clarifies and does not change existing law.

For your consideration there is attached a proposed section 10(e) revised to reflect the requested amendment.

Very truly yours,

F. B. TUTTLE, *Chairman of the Board.*

REVENUE BILL OF 1962

(Sec. 10(e) revised to make effective date January 1, 1954; material deleted from House Bill appears in black brackets and new material is in italic)

(e) ELECTION OF CERTAIN MUTUAL COMPANIES TO BE TAXED ON TOTAL INCOME.—Section 831 is amended by redesignating subsection (c) as subsection (d), and by inserting after subsection (b) the following new subsection:

"(c) ELECTION FOR MULTIPLE LINE COMPANY TO BE TAXED ON TOTAL INCOME.—

"(1) IN GENERAL.—Any mutual insurance company engaged in writing marine, fire and casualty insurance which for any 5-year period beginning after December 31, 1941, and ending before January 1, [1962.] *1954* was subject to the tax imposed by section 831 (or the tax imposed by corresponding provisions of prior law) may elect, in such manner and at such time as the Secretary or his delegate may by regulations prescribe, to be subject to the tax imposed by section 831, whether or not marine insurance is its predominant source of premium income.

"(2) EFFECT OF ELECTION.—If an election is made under paragraph (1), the electing company shall (in lieu of being subject to the tax imposed by section 821) be subject to the tax imposed by this section for taxable years beginning after December 31, [1961.] *1953; provided, however, that with respect to years ending on or before December 31, 1961, such election shall be effective only if the taxpayer filed timely returns (taking into account extensions of time), for the years 1954–1961, inclusive, reporting its income as a mutual marine insurance company and computed its tax liability under sec. 831.* Such election shall not be revoked except with the consent of the Secretary or his delegate."

IOWA MUTUAL TORNADO INSURANCE ASSOCIATION,
Des Moines, Iowa, April 17, 1962.

Subject: Federal Taxation of Mutual Fire and Casualty Insurance Companies.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SIR: The proposed 1962 Revenue Act as recently passed by the House is now before your Senate Finance Committee. Section 10 of the bill rewrites the present Federal income tax law applying to mutual fire and casualty companies. It will greatly increase the present taxload and in many ways impair the ability of such as our association and other companies like it to serve their policyholders at the lowest possible cost.

The official position of mutual fire and casualty companies is contained in the official presentation of the Mutual Insurance Committee on Federal Taxation made on April 13, 1962, by our counsel, Mr. John J. Wicker, Jr., of Richmond,

Va. At this committee hearing there was certainly appreciated the large number of your committee present and the interest shown by your committee.

Some 2 years ago Congress changed the basis of taxing life companies to a partial total income basis. The official representative of our industry, the Mutual Insurance Committee on Federal Taxation, during the middle of the past year was confronted with a "total income" approach by the Ways and Means Committee of the House and accordingly presented to that committee a plan with such an approach under which mutual companies could continue to be a competitive factor with nonmutual or stock private-type companies.

That plan called for an unrestricted "protection against loss account" consisting of 1 percent of incurred losses and 25 percent of underwriting gains, if any; this account to be used only for the payment of total losses in excess of total current income. There was also advocated equitable relief provisions for small mutuals and an increase in the exemption from $75,000 to $150,000. Opposition to this requested suggestion before the Ways and Means Committee was largely by one strictly stock company. The present House passed "total income" approach denies equitable modifications and imposes excessive tax burdens on small and larger mutuals. The present new House bill wording makes ineffectual and worthless the mutual plan as offered.

This factual statement may further point out the needs for the suggested amendments. Our association, having about $3 million per year total income, has just gone through a 10-year period of great fluctuation of income and loss from year to year. At the end of 10 years the loss protective fund would have been depleted under the proposed House version affecting our association and there would have been an unused loss carryforward of $1,350,000. The taxes paid under the present law for 10 years aggregated $277,063 and under the proposed law taxes paid would have aggregated $202,859. In addition, the unused loss carryforward for the next 5 years would be worth approximately $650,000 in tax savings. However, under the present law there would be no savings but additional taxes for the next 5 years.

If a 5-year unused loss carryback provision were used instead of a 3-year, there would have been an additional tax savings of $60,000 over a 10-year period. This association would qualify as a concentrated risk company. In the last 6 out of 10 years an annual underwriting income loss was suffered ranging from a few thousand dollars to over $1,300,000. In 1955 the association would have received a deduction of $999,969 from which the normal deduction of 25 percent of underwriting gains would have been only $340,000. The difference of $659,000 resulted in a tax savings in that year of $310,000. When in 6 other years substantial underwriting losses took place the additions to the loss protective fund, based on 1 percent of incurred losses and 25 percent of underwriting gains, would not have been adequate.

Therefore, the amendments to present H.R. 10650 as outlined on page 21 of the statement presented last Friday should be amended by:

(1) Eliminate the arbitrary 5-year automatic "force out" and ceiling from the protection against loss account;

(2) Eliminate the restrictive provision requiring complete exhaustion of the protection against loss account before use of investment income for policyholder dividends or deviations;

(3) Liberalize the additions to the protection against loss account;

(4) Make adequate the special provisions for concentrated hazardous risk mutuals such as this one, writing over $1½ billion of insurance in force in one State such as Iowa and nearby States;

(5) An option to mutuals with gross income under $1 million to be taxed on investment income only; and

(6) Increase of the existing $75,000 exemption figure for small local township or county mutuals to some figure such as $150,000 exemption.

Last year our association took over the management of another Iowa-domiciled mutual writing largely casualty and fire coverages in four States. Therefore, operation of the hazardous coverage of tornado, wind and hail insurance will be over four States and a serious handicap if restricted to only one by the "mother company" would take place under the present House version.

Over the last 10 years the protection against loss fund for that company would have been adequate to provide for the losses for the fifth year and one-half of the losses for the sixth year, but 4 years of loss protection fund additions would have been liquidated in 1½ years. This company could have enjoyed a 50 percent savings in taxes paid. However, where losses are first applied to the protective fund until it is depleted before the unused loss carryback takes effect,

the unused loss carryback provisions for 3 years should in all cases be extended to 5 years.

The present wording requirement that the fund be depleted before the unused loss carryback provision became effective would normally result in an actual carryback of only 1 year. In the case of this company the loss protective fund would absorb losses for possibly two successive loss years, but losses in the third successive year would be carried back to the last year in which a tax was paid. Again, the requirement that losses first be applied to the loss protection fund makes the unused carryback provision inadequate and meaningless. At least a 5-year carryback for unused losses would be most needed.

A minimum loss protective fund balance should be considered. Such a requirement would enable a company to carryback losses and recover taxes paid in prior years at an earlier date. The minimum balance could be computed on the same basis used to determine maximum balances.

Again, the present House bill imposes an unreasonable ceiling which would prevent any addition to the PAL account if it equals 10 percent of the annual premium volume. Furthermore, the 5-year forceout (return to taxable income) from this PAL account and the 10 percent limitation cripple the very purpose for which it is understood the Ways and Means Committee intended these provisions.

This protection against loss account, made up of the transfer of 1 percent of losses incurred and 25 percent of underwriting gains, if any, is a necessary substitute for the mutuals' lack of access to the capital equity market. Again to repeat, in the case of our association and the company recently taken over the crippling provisions of the House bill reduce the protection against loss account fund to that it would not serve its function as an adequate reserve accumulated in good years to take care of excess losses in bad years. The 5-year forceout provision and the 10 percent limitation provisions must be eliminated.

The change from the present law to a total income basis is very radical. Large companies might be able to adjust to a reasonable total income approach, but small and medium size companies with their less resources will find it difficult and burdensome. It is suggested that companies of our size with gross incomes in excess of $1 million and up to $5 million be permitted to add to their protection against loss account an additional amount equal to 1 percent of the difference in their gross income and $5 million.

Again, with such as our concentrated risk company the provisions are too limited. The House bill provides that mutuals such as ours, deriving more than 50 percent of premium volume in one State, be permitted to put into the protection against loss account in addition to the one-fourth of underwriting gain, if any, a percentage by which premiums on such hazards as windstorm on property or hail on crops exceed 50 percent of our total premiums. One State is too limited as to area of exposure and amount needed in reserve to protect against the good and bad year experience. The 10-percent limitation, as previously referred, does not apply to these concentrated risk mutuals but the forceout does.

We have found from many years' experience the hazards resulting from forces of nature do not confine themselves to State boundaries. The 50-percent limitation is too high and restrictive to be of benefit to those property insurance companies who write windstorm insurance in connection with fire policies.

The present House bill contains certain principles, some of which our group proposed and could accept, but the forceout and imposition of a ceiling if it equals 10 percent of the annual premium volume are recommended be removed. Our mutual proposals do conform and support fair application of the income tax system to total income, but any new changes should take account of the particular nature and form of operation. The survival of our mutual industry as an effective competitive force depends upon substitution of our program for the suggested inequitable and unfair tax provisions.

Thank you for your support of the mutual proposals for amending section 10 of H.R. 10650 having to do with taxation of mutual fire and casualty companies.

Sincerey,

HARRY L. GROSS, *Chairman*.

RESOLUTION BY NEW YORK-BRONX RETAIL MEAT AND FOOD DEALERS, INC., NEW YORK, N.Y.

Whereas (1) There is now pending before the Senate Finance Committee a proposed tax bill, H.R. 10650, adversely affecting mutual insurance companies; and

(2) Our organization is composed of 500 members engaged in the retail meat and food business in New York, whose members are insured with mutual casualty and fire companies; and

(3) The effect of this bill would be to impede the growth and development of mutual insurance whose sole function it is to afford insurance protection to its membership at the lowest cost consistent with safety; and

(4) The proposed bill would discriminate against mutuals in favor of stock companies in that it would prohibit the use of investment income for policyholder dividends unless and until mutual loss protection funds are completely exhausted; and

(5) The proposed bill, by placing unreasonable and unjustifiable time limitation and an unnecessary ceiling on mutual loss protection funds, in effect denies to mutual casualty and fire companies the equal treatment to such companies, as it did allow to mutual life insurance companies, and in this very bill, does allow to mutual savings banks and savings and loan associations: Therefore be it

Resolved, That the New York-Bronx Retail Meat and Food Dealers, Inc., petition the Senate Finance Committee, Senator Jacob K. Javits, and Senator Kenneth B. Keating to vote for the elimination of these antimutual provisions mentioned herein.

DAVID DEERSON, *Chairman of Board.*

RESOLUTION BY NEW YORK HAND LAUNDRYMEN'S ASSOCIATION, INC., NEW YORK, N.Y.

Whereas (1) There is now pending before the Senate Finance Committee a proposed tax bill, H.R. 10650, adversely affecting mutual insurance companies; and

(2) Our organization is composed of 500 members engaged in the laundry business in New York, whose members are insured with mutual casualty and fire companies; and

(3) The effect of this bill would be to impede the growth and development of mutual insurance whose sole function it is to afford insurance protection to its membership at the lowest cost consistent with safety; and

4. The proposed bill would discriminate against mutuals in favor of stock companies in that it would prohibit the use of investment income for policyholder dividends unless and until mutual loss protection funds are completely exhausted; and

(5) The proposed bill, by placing unreasonable and unjustifiable time limitation and an unnecessary ceiling on mutual loss protection funds, in effect denies to mutual casualty and fire companies, the equal treatment to such companies, as it did allow to mutual life insurance companies, and in this very bill, does allow the mutual savings banks and savings and loan associations: Therefore be it

Resolved, That the New York Hand Laundrymen's Association petition the Senate Finance Committee, Senator Jacob K. Javits, and Senator Kenneth B. Keating to vote for the elimination of these antimutual provisions mentioned herein.

BERNARD LUTZKY.

RESOLUTION OF NEW YORK COUNCIL OF WHOLESALE MEAT DEALERS, INC., BROOKLYN, N.Y.

Whereas (1) There is now pending before the Senate Finance Committee a proposed tax bill, H.R. 10650, adversely affecting mutual insurance companies; and

(2) Our organization is composed of 120 firms engaged in the wholesale meat business in New York who are insured with mutual casualty and fire companies; and

(3) The effect of this bill would be to impede the growth and development of mutual insurance whose sole function it is to afford insurance protection to its membership at the lowest cost consistent with safety; and

(4) The proposed bill would discriminate againt mutuals in favor of stock companies in that it would prohibit the use of investment income for policyholder dividends unless and until mutual loss protection finds are completely exhausted; and

(5) The proposed bill, by placing unreasonable and unjustifiable time limitation and an unnecessary ceiling on mutual loss protection funds, in effect denies to mutual casualty and fire companies, the equal treatment to such companies, as it did allow to mutual life insurance companies, and in this very bill, does allow to mutual savings banks and savings and loan associations: Therefore be it

Resolved, That the New York Council of Wholesale Meat Dealers, Inc., petition the Senate Finance Committee, Senator Jacob K. Javits, and Senator Kenneth B. Keating to vote for the elimination of these antimutual provisions mentioned herein.

JOSEPH KAUFMAN, *President*.

STATEMENT OF ARMUND J. SCHOEN, CHAIRMAN OF THE BOARD OF DIRECTORS OF THE AMERICAN AUTOMOTIVE LEASING ASSOCIATION

On May 21, 1961, I appeared before the House Ways and Means Committee, which was then deliberating on the President's recommendations on tax revision, and I presented to the committee a statement on behalf of the American Automotive Leasing Association (which was endorsed by the Car and Truck Renting and Leasing Association) in which I pointed out in some detail the very serious adverse effect that the President's proposals, if enacted, would have on the automotive leasing industry. My testimony is set forth at pages 1011-1018 of volume 2 of the hearings (hearings before the Committee on Ways and Means, House of Representatives, 87th Cong., 1st sess., on the tax recommendations of the President contained in his message transmitted to the Congress, April 20, 1961, vol. 2, pp. 1011-1018), and there would seem to be no need to burden unduly the hearings of this committee by duplicating here my testimony before the House Ways and Means Committee. Reference is made to my testimony for the full details of the summary which I propose to set forth herein.

The members of the long-term automotive leasing industry purchase about 150,000 new cars each year for fleet leasing, and, at the present time they have on lease to industrial and commercial lessees approximately 300,000 passenger vehicles. This represents an investment of about three-quarters of a billion dollars. The history and development of the industry, the reasons for its growth, and a description of the typical method of operation are set forth in my testimony. It suffices to state here that one of the primary reasons for the growth of automotive leasing is that it offers lessees the advantage of releasing large amounts of capital for investment in plant and equipment that would otherwise be tied up in company-owned fleets. Automotive leasing thus makes a positive contribution to the productive investment potential of the Nation's businesses and directly facilitates the objectives emphasized in the President's tax message and in Secretary Dillon's statement and testimony: namely, to increase the modernization, productivity, and competitive status of American industry and to stimulate the expansion and growth of our economy.

The combined effect of two provisions in H.R. 10650, however, would frustrate the automotive leasing industry's ability to maintain and expand the service it offers to American industry. These are (1) the provisions in section 14 eliminating the capital gains treatment of gains realized on the disposition of depreciable assets, and (2) the limitations in section 2 relating to the credit for investment in depreciable property which require that an asset in order to qualify for any credit, must have a useful life of 4 years or more.

Leased automobiles generally have a useful life of approximately 18 to 24 months because of the lessees' demand for relatively new vehicles in their service, and the result is that the automotive leasing industry would not qualify at all for the investment credit. If H.R. 10650 is enacted into law in its present form, the automotive leasing industry, far from being advanced by this legislation, would be seriously disadvantaged. It would lose its existing right to treat on a capital gains basis any gains that might be realized on the disposition of vehicles, and, at the same time, it would achieve no benefit from the investment

credit provisions because it could not qualify under the presently proposed 4-year useful life requirement. In this connection it is interesting to note that Secretary Dillon, in his statement on May 8, 1961, to the House Ways and Means Committee, defended the withdrawal of the capital gains privilege by stating that "this reform is particularly essential at this time in view of the recommendations to provide a tax credit for new investment in depreciable property." This justification obviously has no application to assets, such as ours, which are held for too short a period to qualify for the investment credit under the presently proposed arbitrary 4-year useful life requirement.

One further aspect of the proposed legislation needs comment at this point. Section 14(c)(1), which adds a new section 167(f) to the Internal Revenue Code of 1954, allows the estimate of salvage value for depreciation purposes to be reduced by 10 percent of basis of the asset, thereby increasing the permissible depreciation deduction. This privilege, however, is accorded only with respect to assets having a useful life of 3 years or more, and, for reasons already set forth, even this is not available to the automotive leasing industry.

Here, then, is a piece of proposed legislation which is stated to have as its major purpose an incentive to investment in plant and equipment, but every provision which I have noted has precisely the opposite effect on the automotive leasing industry, resulting not only in the inability of the industry to expand or even maintain its services to American industry, but also in frustrating the very purpose which the legislation is stated to have. There is no doubt in my mind that if this legislation is enacted in its present form, fewer, and not more, automobiles will be purchased in this country annually.

A few words here are appropriate concerning the proposal to eliminate the right to treat on a capital gains basis any gain on the disposition of depreciable assets. The capital gains privilege has been of peculiar importance to the automotive leasing industry for a number of very legitimate reasons and has played a significant role in facilitating the expansion of investment in this industry, thereby permitting it, in turn, to meet the needs of American industry. On pages 1013-1016 of my testimony before the House Ways and Means Committee I have discussed this matter in some detail, and reference is here made to that statement. Without here going into the data and statistics there set forth, I would like, however, to refer to just three paragraphs which state the general conclusion to be drawn:

"At the same time, the elimination of the capital gains privilege on the sale of depreciable assets would deny us the modicum of protection we had previously enjoyed against the erosion of our capital resulting from the sharp upward trend in new automobile prices that prevailed throughout the last decade. Had it not been for this degree of protection during those years, we would have encountered extreme difficulty not merely in expanding but even maintaining our fleets in the face of these rising prices. * * *

"The capital gains actually recorded during this period of rising prices by the members of our industry are, in fact, attributable largely to this steady rise in new car prices which exercised a substantial sustaining influence on the used car market. As a result, our members were often able to resell their cars at prices somewhat higher than they had anticipated at the time they put them in service and established their depreciation plans. The resultant tax saving, by reason of the capital gains privilege, played an important part in permitting our members to conserve their capital to the extent needed to permit them to replace used equipment with constantly more expensive new models * * *.

"I should like to stress at this point that the automotive leasing industry is in a peculiarly weak position in a period of rising prices in terms of the maintenance of the value of its capital. The monthly rentals are fixed at the time the cars are leased and cannot be increased during the life of the leases in order to compensate for rising replacement costs. The average manufacturing or commercial establishment does not have this problem, at least in the same degree. Thus, as increases in replacement costs for machinery occur or are foreseen, the prices of products manufactured by the machinery can be and regularly are increased. Whether such increases can be sufficient to compensate fully for higher costs of machinery replacements will depend, of course, upon the competitive position of the specific industry. The automotive lessors, however, cannot avail themselves of this form of protection to any degree at all.'

At the time of my testimony before the House Ways and Means Committee, the investment credit proposal was limited to assets having a useful life of 6 years or more, and no smaller credit was available for shorter lived assets.

We recognized that the full tax credit would not be appropriate for shorter lived assets such as motor vehicles, and my statement contained several suggestions for more limited credits, in the event that the capital gains rights were in fact eliminated. Thereafter the useful life requirement was reduced to 4 years by the House Ways and Means Committee, and H.R. 10650, as it passed the House, contains the 4-year useful life requirement, with a more limited credit for such shorter lived assets. The contemporaneous newspaper stories at the time the House committee reduced the qualifying period from 6 to 4 years indicated that one of the purposes was to include automobiles within the scope of the tax credit provisions.

But the reduction to a 4-year useful life is of no help to the automotive leasing industry. Leased cars must be disposed of and replaced usually no later than 2 years from the beginning of service. If there is any disposition to avoid the resulting damage to the automotive leasing industry, and if the capital gains provisions of existing law are to be, in fact, eliminated, then the useful life requirement for qualifying for the tax credit must be further reduced to a period of 18 or 24 months with a corresponding reduction in the amount of the credit for such shorter lived assets.

(Whereupon, at 3:10 p.m., the committee recessed, to resume Monday, April 16, 1962, 10 a.m.)