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EXEMPTING GAIN FROM THE SALE OR OTHER DISPOSITION OF TREASURY BILLS FROM TAXATION

June 9 (calendar day, June 11), 1930.—Ordered to be printed

Mr. Smoot, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 12440]

The Committee on Finance, to whom was referred the bill (H. R. 12440) providing certain exemptions from taxation for Treasury bills, having had the same under consideration, report it back to the Senate without amendment and recommend that the bill do pass.

Following is a copy of the House report on the bill:

[House Report No. 1609, Seventy-first Congress, second session]

The Committee on Ways and Means, to whom was referred the bill (H. R. 12440) providing certain exemptions from taxation for Treasury bills, having considered the same, report it back to the House without amendment and recommend that the bill do pass.

The immediate enactment of this bill is urged by the Treasury Department.

About a year ago Congress authorized the Treasury to issue a new form of short-term Government security, to be known as a Treasury bill and to be sold at a discount. Under that authorization there have been four issues of Treasury bills. These issues have come up to expectations and have been successful in the sense that the Treasury obtained money at reasonably low rates and that the Treasury bill enabled the Treasury as a practical matter to borrow money when actually needed, instead of, as the Treasury had been accustomed to do before it had this new instrument, on the quarterly tax payment dates.

Gains from the sale or other disposition of Treasury bills are subject to income tax at the present time, and losses therefrom are deductible. But, in order to ascertain capital gains or losses, as differentiated from the discount received on these Treasury bills, it is necessary that those dealing in the securities keep a complicated system of bookkeeping records, resulting in such an enormous amount of detail that a very real sales resistance has developed.

Although gains from the sale or other disposition of Treasury bills are subject to income tax, little or no revenue is to be anticipated therefrom because, unless the Treasury bill during its brief existence should happen to pass through the hands of men whose income is taxed at different rates, the gains and losses during the course of the 90 days will offset each other, with the result that so far as the Government is concerned there is no capital gain or loss. Treasury bills are bought mostly by corporations—which are, of course, taxed at the same rate. They are largely bought by banks, large insurance companies, and other corporations with funds to invest temporarily. Moreover, the maturity is so short and fluctuations are likely to move within such a narrow range that the amount involved on account of capital gains and losses is inconsequential.

On the last issue of Treasury bills there were no less than 17 different rates of discount, representing the different competitive bids that were accepted. In other words, on one issue of Treasury bills there were 17 different rates of discount. The dealer who acquires those bills can not treat them as one issue. In order to arrive at the capital gain or loss, he must take each lot of Treasury bills sold at a particular discount rate and open an account for that particular lot, showing the price at which originally sold by the United States, the price paid by him for the bill, what he sold it for, and what the accrued discount is for the period during which he held the security.

J. H. Case, Esq., chairman of the board of directors of the New York Federal Reserve Bank, who in the course of the last 13 or 14 years has had as much experience with the Government security market as any man in the United States, became seriously concerned over this situation, and on April 21, 1930, he addressed a letter to Undersecretary of the Treasury Ogden L. Mills, which letter reads in part as follows:

"But more convincing evidence of the difficulties which this type of financing is likely to encounter is found in the acute situation which has arisen in the experience of purchasers of the bills in subsequently disposing of their bills in the market. It is in this connection that this form of financing has recently encountered such serious difficulties as to justify the most careful consideration of some modification of the provisions governing their issuance.

"The sale of Treasury short-term obligations on favorable terms is dependent upon a group of traders or dealers in short-term investments who always stand ready to buy or sell obligations of this sort. The desirability of the Treasury bill depends on the holders being able to liquidate it at any time at a fair price, and these dealers constitute the market where this is always possible. In this market, as in all money markets with which I am familiar, the buyers of Government and other short-term securities such as bankers' bills and city of New York warrants usually acquire such securities as needed through this group of dealers, and if they want to realize on the securities, sell them to or through these dealers. The popularity of the security depends on its being traded in freely in this way.

"We have been hoping that the United States Treasury bill would take its proper place in this market and become a desired instrument for short-term investments by banks, corporations, and individuals. But the fact is that the dealers now find the market almost closed to these new Treasury bills, solely on the ground of the bookkeeping complications which necessitate such an enormous amount of detail that prospective buyers refuse to take them.

"A letter I have just received from Mr. E. C. Wagner, president of the Discount Corporation of New York, which is one of the largest dealers in Government securities, indicates the difficulties they are encountering.

"The difficulty lies in the fact that the tax exemption of the income from Treasury bills has to be computed by the buyer not on the basis of price at which he purchases the bill but on the basis of the original sale price, which is not the same for all bills issued at a given date, for parts of each issue are sold at different prices, and, moreover, the holder of a bill must compute a capital gain or loss from the time of his acquisition of the bill to disposal or maturity. In this way an issue of Treasury bills can not be quoted at any given price, but the seller and buyer have to make a series of computations for each transaction and the dealers find that for each bill they handle they have to keep an account on a daily accrual basis. The discount houses print and circulate daily offering sheets, and in the case of Government securities their lists show the price of each issue, the true interest yield, and in a separate column the yield to corporations after an allowance has been made for tax exemptions, but in the case of Treasury bills it is impossible to show the yields on a taxable basis because of the various prices at which the bills were bought or sold and results, perhaps, in a dozen different calculations in the tax-exempt feature. All of this bookkeeping brings the Government no net return, for one holder's loss exactly offsets another's gain.

"These difficulties are so great that a number of important buyers of Treasury obligations are withdrawing altogether from the purchase of the bills, and I am convinced that unless the present law can be modified the Treasury may presently have difficulty in continuing this method of financing on a satisfactory basis."

There is also quoted the letter from E. C. Wagner, Esq., president Discount Co. of New York, one of the largest dealers in Government securities, which is referred to in the letter from Mr. Case and which indicates the difficulties that

that company is experiencing because of the necessity for computing capital gains or losses resulting from the sale or other disposition of Treasury bills:

DISCOUNT CORPORATION OF NEW YORK,
New York City, April 17, 1930.

Mr. J. HERBERT CASE,
Chairman of the Board Federal Reserve Bank of New York,
New York, N. Y.

DEAR MR. CASE: You are, I know, well informed in regard to the disappointment on the part of the money market when the announcement was made that the exemption of income derived from an investment of United States Treasury bills would be measured by the discount actually received for each individual bill at the time of issue.

This corporation performs an important function in endeavoring to even up the temporary surplus funds of banks and bankers through our holdings of bank acceptances and short-time Government securities. In order to obtain more favorable rates for money, it has been our custom to farm out our holdings of short-term Government securities by means of repurchase agreements, so that the investor of money gains the benefit of the exemption of taxation from the income derived. In this manner we frequently place out blocks of $5,000,000, or more of one issue of certificates, the coupon being the same for the entire block.

We have been unable, however, to arrange repurchase agreements in the case of United States Treasury bills, because a block of Treasury bills may have been bought at a dozen different rates of discount and the calculation of the benefit of the tax exemption is too complicated for the moneyed party borrowed from. We are, therefore, obliged in the case of Treasury bills to rely on straight loans and pay the full rate of interest. Moreover, the interest which we pay is not deductible as an expense on our income-tax return. All of this makes the financing of the purchase of Treasury bills very difficult for dealers.

I have taken up the matter of financing the carrying of Treasury bills because, after all, that is the first thing a dealer has to do when handling them. The next step is to arrange a sale. There, again, we meet with considerable sales resistance on the part of banks and bankers, who appear to so strongly object to the work necessitated in calculating the exemption from taxation of the resulting revenue.

When visiting banks with the object of making trades or borrowing money, one normally would only have to bear in mind that one had $5,000,000 or $10,000,000 United States Government certificates to sell. In the case of Treasury bills, it is not only necessary to know the dollar volume but a dealer must carry with him the particulars of the original discount at which they were bought, so as to be able to inform the buyer of the conditions of the suggested purchase.

The net result is that whereas the market anticipated that the United States Treasury bill would become the premier security of the world and the most easily traded in, it is in fact to-day the least popular of all United States issues.

We have no hesitation in saying that in our opinion Congress should change the law so that the current market discount is exempt from taxation. If this is done, holders of Treasury bills need make only one entry of the income, instead of which we are obliged to carry a complicated set of books, copies of which are handed you with this letter. If you can prevail upon the Secretary of the Treasury to appeal to Congress to make the necessary change in the act, it will do much to broaden the market for Treasury bills and insure the capacity of the Government to continue to borrow in this form on advantageous terms.

Thanking you for your customary courtesy, we are,

Yours very truly,

E. C. WAGNER, *President.*

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