

Calendar No. 525.

65th CONGRESS, }
2d Session. }

SENATE.

{ REPORT
No. 571.

SUPPLEMENTARY BOND LEGISLATION.

SEPTEMBER 17, 1918.—Ordered to be printed.

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

REPORT.

[To accompany H. R. 12923.]

The Committee on Finance, to whom was referred the bill (H. R. 12923) to supplement the second liberty bond act, as amended, and for other purposes, having had the same under consideration, report it back to the Senate with sundry amendments and recommend that the bill as amended do pass.

The report of the Ways and Means Committee, which explains the bill, is hereto attached and made a part of this report.

The amendments recommended by your committee are that section 5 of the bill be stricken out, and that sections 6 and 7 be renumbered 5 and 6, respectively.

[House Report No. 778, Sixty-fifth Congress, second session.]

The Committee on Ways and Means, to whom was referred the bill (H. R. 12923) to supplement the second liberty bond act, as amended, and for other purposes, having had the same under consideration, reports it back to the House without amendment and recommends that the bill do pass.

PURPOSE OF THE BILL.

The chief purpose of this legislation is to provide a limited exemption from income surtaxes and war and excess-profits taxes upon income to be derived from the fourth liberty loan bond issue, the flotation of which is to open on September 28, and also to free a larger portion of the income from the first, second, and third liberty loan issues from similar taxation. Your committee believes that this legislation will materially assist in the sale of the next liberty bonds.

THE NEW MEASURE.

INTEREST FROM LIBERTY LOAN BONDS EXEMPT.

Section 1 of the proposed bill provides that interest on fourth liberty loan bonds not in excess of \$30,000 owned by any person, partnership, corporation, or association shall be exempt from surtaxes and excess-profits or war-profits taxes.

This section also provides that the interest from the first, second and third liberty bonds shall be exempt from surtaxes and excess-profits or war-profits taxes to the extent of one and one-half times

the amount of fourth liberty loan bonds subscribed and held, upon the date of the tax return, by any such taxpayers, but it is provided that such exemption shall not exceed \$45,000 of such bonds.

A further provision is added to the effect that if any taxpayer converts first liberty loan bonds by reason of the issuing of the fourth liberty loan bonds, he shall be entitled to similar exemptions to the extent of \$30,000 of such bonds. It is provided, however, that in all of the above cases the interest from these bonds shall be only exempt from these taxes until two years after the termination of the present war.

WAR-SAVINGS CERTIFICATES.

The bill provides in section 2 that the amount of war-savings certificates available to be issued shall be increased from \$2,000,000,000 to \$4,000,000,000, and that the amount of war-savings certificates of any one series that may be held by any one person shall not exceed \$1,000. In other words, any person may purchase \$1,000 of war-savings certificates of the present series and an additional \$1,000 for each succeeding series which may be issued.

WAR-PROFITS TAXES TO BE DEPOSITED WITH GOVERNMENT DEPOSITARIES.

Section 3 of this bill authorizes the Secretary of the Treasury to deposit with designated Government depositaries the proceeds arising from the payment of war-profits taxes as well as from income or excess-profits taxes. The second liberty loan act authorizes the Secretary of the Treasury to deposit in depositaries the proceeds from income and excess-profits taxes. As the pending revenue bill provides for a war-profits tax, this section becomes necessary.

STABILIZATION OF FOREIGN EXCHANGE.

Authority is given in section 4 of this bill to the Secretary of the Treasury to make arrangements in or with foreign countries to stabilize foreign exchange. This provision is deemed necessary in order to give the Secretary of the Treasury greater flexibility in Treasury operations with respect to our dealings in foreign countries.

AMENDMENT TO TRADING-WITH-THE-ENEMY ACT.

Section 5 of this bill amends clause (b), section 5 of the trading-with-the-enemy act so as to empower the President to investigate, regulate, and prohibit, by means of license or otherwise, transactions in bonds or certificates of indebtedness of the United States and the hoarding or melting of gold or silver, in addition to the powers already granted the President under such section.

LOANS MADE BY NATIONAL BANKS.

Section 6 of the bill incorporates the provisions of H. R. 10691 entitled "An act to amend section 5200 of the Revised Statutes, as amended," which has already passed the House in this session of Congress. Section 5200 of the Revised Statutes limits the amount of loans which national banks can make to any one borrower to one-tenth of the capital stock and surplus of such banks. The effect of the amendment to section 5200 of the Revised Statutes is to permit

any national bank to lend a borrower, in addition to the aforementioned amount, an additional amount not to exceed 10 per cent of the capital stock and surplus of such bank in case the borrower discounts with such bank a note or notes secured by not less than a like amount of bonds of the United States issued since April 24, 1917, or certificates of indebtedness.

SHORT TITLE OF THIS ACT.

Section 7 provides that the short title of this act shall be "Supplement to second liberty bond act."

The letter of the Secretary of the Treasury with reference to this bill is hereto appended and made a part of this report.

TREASURY DEPARTMENT,
Washington, September 5, 1918.

DEAR MR. KITCHIN: In connection with the tax bill now before the Congress, and without awaiting its enactment, I feel constrained to bring to your attention a matter affecting the fourth liberty loan. The delay in the enactment of the tax bill, the fact that the rates of income surtaxes, to which the interest on liberty bonds, except the first liberty loan, is subject, will be higher, and the rate of normal income tax on unearned income will be lower, than I had contemplated, materially affect the prospects of the fourth liberty loan.

I do not mention these things critically, for I realize that the Ways and Means Committee have labored faithfully and earnestly during the hot summer months in the consideration and preparation of the tax bill. I have already expressed my acceptance of a normal tax of 12 per cent without a differential against unearned incomes, and in principle I am now agreed with the committee that a substantial increase in surtax rates will be necessary in order to produce the indicated revenue.

The market price of liberty bonds, which responded favorably to the suggestion of an increased normal tax, from which the bonds will be exempt by their terms, was depressed by the newspaper reports of a greatly increased surtax, to which the interest on the bonds will be subject. I have been anxious to stabilize the interest rate upon Government bonds, believing that by so doing we should be reducing the cost of the war, not only to-day for ourselves, but, in the future, for ourselves and for our brave men who are fighting in France and who will have little or no opportunity to accumulate and invest in liberty bonds though they must upon their return join the army of taxpayers who must pay this interest. I have sought to avoid the issue of bonds at such a rate and upon such terms as might result ultimately, when the war is won, in the accumulation of great wealth in the hands of a relatively small proportion of our population, carrying interest at a high rate and exempt from taxes.

The magnificent patriotism of our people and the fervor and efficiency of the liberty loan organization have made it possible to place the liberty bonds in the hands of many millions of persons who had never before been investors in securities of any kind. Bonds of the third liberty loan received the widest possible distribution and I feel that we all owe a duty to the millions of subscribers of small means not merely to pay them a fair rate of interest, which we are doing, but to take such measures as may be necessary to insure to them a market for the bonds at approximately par in case their necessities are such as to force them to realize upon the investment which they have made in the Government's obligations. The bond-purchase fund, which was provided in the third liberty bond bill, has been very useful in stabilizing the price of liberty bonds but it has not been, and we could not expect it to be, effective to sustain the price against adverse developments, and in the face of the fact that the Government's recurring demands upon the absorptive power of the investment community are in such proportions and of such frequency as to prevent the development of any important buying power in the investment market between liberty loan campaigns.

I have been much impressed by the success of the plan which has been adopted in Canada for the purpose of maintaining the market value of Canada's victory bonds. A careful study of that plan is being made in the Treasury and by the War Finance Corporation, and I am glad to learn that the bankers of the country have been making a similar study. I am not without hope that some such plan may be made effective in the United States, although conditions here are very different and it will not do to depend too much upon the experience of our neighbor. In any event, it will

not do to proceed in this matter abruptly, nor without the creation of an immense organization country wide in its ramifications. To make such a plan effective, it would be necessary to put an end to dealings in bonds on the exchanges, and accordingly to substitute an active and adequate market through the banking houses of the United States acting in close cooperation with an instrumentality of the Government, probably the War Finance Corporation. At the same time, it would be necessary to put an end to the numerous schemes, many of them actually fraudulent, for inducing inexperienced holders of liberty bonds to exchange them for merchandise or property of less inherent value though carrying the promise of a higher value or a higher income return. In order that the Treasury may be placed in a position to carry such plans as these into effect, if they should be found expedient, I suggest for your consideration the present enactment of appropriate legislation.

Last year I had the privilege of explaining to you and your colleagues on the Ways and Means Committee very fully the reasons why I advocated making the income from liberty bonds subject to income surtaxes. I still believe that that course was wise and that the arguments advanced in favor of it were sound. It will not do, however, to press any theory, however sound, to an extremity, and it is obvious that as a practical matter, we can not keep the interest rate on Government bonds stationary, or substantially so, and continue indefinitely to increase the surtaxes, to which the income from those bonds is subject without at the same time limiting the market for liberty bonds to those who have little or no surtaxes to pay. Since the bond and tax legislation which was under discussion in the summer of 1917 and which was enacted in the fall of 1917, the interest on liberty bonds has been increased only one-fourth of 1 per cent, whereas the surtax rates now in contemplation would carry an increase in the taxes to which the interest on the bonds is subject rising above 150 per cent increase in some classes. Surtaxes on incomes from \$5,000 to \$200,000 would, under the new tax bill, on the average be doubled. In order to give the numerous small holders of liberty bonds the advantage of a market upon which they may sell their bonds in case of necessity, and also to attract subscriptions from the great number of investors of ample means, but not of great wealth, it will be necessary immediately either to increase the interest rate, or to neutralize the increased surtaxes by freeing the bonds to a limited extent from such taxes.

I recommend that a portion of the income of these bonds should be free from surtaxes for the period of the war and for a brief interval thereafter. This course would make it possible to meet the exigencies of the present situation and to counterbalance the adverse effect on the market value of liberty bonds of the increased surtax rates, and at the same time would not be open to the very grave objection which exists against any unlimited or permanent exemption, which would deprive the Government of the United States of the power to meet its necessities in the future by super-taxes on incomes derived from liberty bonds. If the surtax rates should be reduced after the war, the interest which is fixed in the bonds would continue. Having, as I believe in fairness to the patriotic people who will subscribe for the fourth liberty loan, to choose between one of two methods for making the bonds more attractive, neither of which is wholly satisfactory, I am inclined to recommend at this time that the holders of these bonds be given a qualified and limited freedom from surtaxes in respect to their holdings rather than that the interest rate should be increased. I believe that, on the whole, the wise and expedient thing is to grant a limited exemption calculated to counterbalance the increase in surtax rates now contemplated, and which I believe will be only temporary, rather than to increase the interest rate on liberty bonds for the life of the bonds.

I am influenced in this determination by the fact that it continues necessary to sell liberty bonds in competition with billions of dollars of bonds of the United States, the various States and municipalities, which are wholly exempt from surtaxes, as well as from all forms of taxation, so that the person whose income is subject to surtaxes is apt to make a comparison of the income return from the liberty bonds which he is asked to subscribe for, not with the income return from corporation and other securities such as carry no exemption from taxation, but with the income return from wholly exempt bonds of the United States and the various States and municipalities. Under the existing state of the Constitution and laws, such a comparison can not be avoided. In these circumstances, we must find a middle ground between the sound view which would refuse all exemptions from surtaxes, and the practical necessity of taking into account the fact that such exemptions will in any event be gained, as surtaxes are steadily increased, by shifting funds into governmental, State, and municipal bonds, the income from which is exempt from surtaxes as well as from normal taxes.

In granting such exemption, I think appropriate provision should be made to the end that those who subscribe for bonds of the fourth liberty loan may, to the extent

of a specified portion of their holdings, participate in the exemption in respect to bonds of the first liberty loan converted, the second liberty loan converted and unconverted, and the third liberty loan.

Should these views commend themselves to the Congress, I believe that immediate action should be taken so that the status of the bonds of the fourth liberty loan, in respect to taxation, may be promptly known. It is, in fact, imperative that this status should be quickly known.

There are certain other matters to which I desire to call the attention of your committee at this time:

The provisions of section 8 of the second liberty bond act, as amended by the third liberty bond act, should be extended so as to authorize the Secretary to deposit the proceeds arising from the payment of war-profits taxes with qualified depository banks and trust companies in the United States in the same manner as the proceeds of income and excess profits taxes.

The time has come to make provision for the sale of war savings certificates in 1919. The limit of \$1,000 on the amount which may be held by any one person should be made to apply separately to the series which will be issued in 1919, so that one holder may own \$1,000 of that series in addition to \$1,000 of the series of 1918. At the same time the limit of \$2,000,000,000 now imposed on the aggregate amount of the issue should be enlarged, or, better, removed, for the necessary distribution of the war savings stamps among thousands of post offices and other agencies engaged in making sales over the counter may make the limit very embarrassing long before the cash receipts of the Treasury indicate that the limit is about to be reached.

In the negotiations which I have had and am having with or in foreign countries in the effort to stabilize foreign exchange, I find myself seriously hampered because I am without the freedom of action which is possessed by the finance ministers of European countries. I may only sell bonds or Treasury certificates of indebtedness which involves often international complications, and may not obtain banking credits nor operate as freely as may be necessary in the effort to stabilize exchange. Notwithstanding these restrictions, the Treasury has been able to make substantial progress in dealing with this difficult problem. I urge upon you, however, the incorporation in the law of the necessary authority to give greater flexibility to the operations of the Treasury in this respect.

I believe it is highly desirable at this time that the President should be empowered to investigate, regulate, or prohibit not only the export or ear-marking of gold or silver coin or bullion or currency, but also the hoarding or melting thereof.

Last March I called the attention of the Congress to the importance of amending the provisions of section 5200 of the Revised Statutes limiting the amount of loans which national banks may make to any one borrower. A bill was reported by the Banking and Currency Committee of the House, H. R. 10691, passed by the House and reported with amendments by the Committee on Banking and Currency of the Senate, but not acted upon by the Senate. The Senate did pass a bill, Senate 4099, dealing to a certain extent with the same subject matter, prior to the Senate committee report on the House bill; and on the Senate bill no action has been taken by the House. It is essential that this matter be disposed of before the fourth liberty loan is offered.

By way of suggestion and in order the better to formulate my views for your consideration, I have taken the liberty of preparing a bill which would deal with the various points I have mentioned in this letter. A draft of this bill is inclosed. May I not ask that the Ways and Means Committee give these points its immediate attention with a view to the enactment of the necessary legislation, if my suggestions commend themselves to the committee, in ample time to become effective before the opening of the fourth liberty loan campaign on September 28? I feel that the success of this loan is deeply involved in this legislation.

Mr. Leffingwell is fully informed of my views concerning these matters and is authorized to speak for me in my absence should the committee desire any further information.

Cordially, yours,

W. G. McADOO.

Hon. CLAUDE KITCHIN,
*Chairman Ways and Means Committee,
House of Representatives, Washington, D. C.*

P. S.—I am sending a copy of this letter and the inclosure to Senator Simmons.

