

February 26, 1937.

Mr. Roswell McGill, Undersecretary, Treasury Department

Paul P. Gourrich, Director, Research Division  
Securities and Exchange Commission.

Proposed Transfer Tax on Foreign Transactions.

In accordance with the request made by Mr. Kent on Wednesday, we have prepared a brief and hurried memorandum on our position with respect to the proposed tax on transfers of American securities into and out of the names of foreigners.

The memorandum is only the expression of my personal view, as well as of the opinion of my immediate associates. Chairman Landis has not had an opportunity to comment on this memorandum due to his departure for Boston. The memorandum is not to be regarded in any way as an official expression of the Commission's point of view.

We have unfortunately not been able to utilize whatever may have transpired at the meeting held yesterday at the Treasury of which we were not cognizant. Our conversations with people present at the meeting, however, lead us to the impression that the discussion would not have led us to modify our views or suggestions considerably.

Gourrich  
Goldschmidt/MKC

MEMORANDUM OF SECURITIES AND EXCHANGE COMMISSION ON  
PROPOSAL OF A TRANSFER TAX ON THE PURCHASE AND  
SALE OF AMERICAN SECURITIES BY FOREIGNERS

This draft represents solely the personal views of  
Mr. Paul P. Gourrich and Mr. R. W. Goldschmidt and  
has not been approved by the Securities and Exchange  
Commission.

1. We understand that the Treasury in the course of the program of stopping the influx of foreign money to the United States is now considering a tax on the transfer of American securities into, and possibly also out of foreign names. This tax is intended to supplement the withholding tax at the recommended increased rates of 20% of interest or dividends.

2. While an evaluation of this proposal must, to a considerable extent, depend on the rates of the tax which have not been indicated in the memorandum prepared by the Treasury – we understand, however, that a rate of 3% has been mentioned – the Securities and Exchange Commission is inclined to regard this proposal for the reasons detailed below with the gravest apprehension. The Commission is of the opinion that the proposal will most likely fail to attain its object of stopping the net inflow of foreign money into our securities markets and will have unfavorable repercussions on our markets far outweighing its advantages. The proposal lacks the justification of equity and is patently discriminatory. An attempt to enforce higher withholding rates and adequate rates on capital gains made by foreigners seems to be so much superior in equity and logic to the present proposal and so much more likely to attain the desired end that the Commission feels it should be at least tried, notwithstanding all administrative difficulties, before recourse is had to a scheme so fraught with serious drawbacks and dangers.

3. Any transfer tax of this type, whether high or low, will have the tendency to drive the trading in American securities now owned by foreigners and held here or abroad and on securities to be acquired in the future almost exclusively to foreign security markets.

If the tax is low, it will most likely be paid on the first transfer into a foreign name in situations where net purchases in the United States become necessary, i.e., where the demand on foreign markets can not be satisfied out of the supply available abroad. Immediately afterwards, however, the securities purchased here will be exported in the form of certificates in street names and henceforward traded abroad evading all further transfer taxes. If the tax is high, even the first payment will be evaded in many cases. The same considerations apply to sales and transfers out of foreign names.

In both cases evasion will be extremely simple if certificates in street names may be shipped abroad or received from abroad. Even if this be prohibited, American dummy nominees will spring up, either individuals or corporations, who will buy or sell the securities in their own name. With a high tax, smuggling of the actual securities will become so profitable that all the usual penalties for tax evasion and the usual methods of detection will fail.

Simultaneously, with the development of the markets in American securities abroad, there will spring up British, Dutch, etc. certificates for U. S. Steel, General Motors, etc., and the price for such certificates and in general for American securities abroad will differ from the price quoted in our stock exchanges, usually by about the amount of the transfer tax. The prospects of such markets, and the innumerable bootleg transactions to which they will give rise are rather terrifying.

5. Foreign trading in American securities at the present time accounts for fully 10% of stock trading in our markets. During 1936 purchases and sales of American stocks for foreign account aggregated over \$3,000,000,000. The net foreign purchase balance, however, is much smaller than this, the total trading for foreign account aggregating from 5 to 10 times the net purchase balance.

If the transfer tax is low, it will prevent neither long term nor short term net purchases although it will drive in and out trading in American securities to foreign markets. It will thus effect mostly the bona fide investor and not the speculator to whom carrying charges mean very little as the experience of 1929 has shown. If the tax is high, it will hit least the long term investor because in his calculations it will be spread over a considerable number of years and, therefore, will constitute only a small part of the expected profit. There is reason to assume that the greatest part of the inflow of foreign money into our stock market is due to purchases by long term investors. Therefore, a reduction of net purchases is unlikely unless the rates be very high – and the proposed 3% are not, at least not for this purpose – and if they are very high evasion will nullify the whole scheme.

The transfer tax will thus not accomplish the purpose of reducing the inflow of foreign money into our securities market, but it will reduce the business done by American brokers for foreign account very considerably and will diminish their total business by about 5 to 10%. Most of the business now done here will simply reappear in London and other foreign centers and increase the income of foreign brokers. If it is remembered that last year the value of stock exchange business for foreign account was around \$5,000,000,000, the importance of such a transfer from our markets to foreign markets will be readily appreciated.

6. The most serious consideration from the point of view of the Securities and Exchange Commission is that this tax will add the most powerful incentive to the forces already now at work to make London and, to a smaller extent, Amsterdam and other foreign financial centers, into really powerful competitors of our stock exchanges in the trading of American securities. It may easily lead to a destruction of the representative character of our stock exchanges and to nullification of the control of the Securities and Exchange Commission over American exchanges. If markets for American securities abroad are sufficiently developed as a result of the diversion of foreigners' trading, Americans may be attracted to do part or all of their trading there, notwithstanding the fact that it is proposed to apply a transfer tax in such cases if they are reported to the Treasury.

7. Should transfers from foreign names into American names be made taxable, the repatriation of American securities now owned by foreigners and later to be acquired by foreigners will be made difficult, although such repatriation should be made as easy as possible at the present moment. On the other hand, if transfers out of foreign names are not made taxable, the plan will lose one of its few advantages, that of providing a cushion against a sudden wave of foreign selling.

8. While an increase in the withholding rates and the introduction of a modified regime of taxation of capital gains can be well defended on reasons of equity as representing an approximation to equal treatment of Americans and foreigners, the proposed transfer tax is patently discriminatory. All of the arguments advanced by the representatives of the Department of State against discriminatory taxation, which in our opinion may be rebutted to a certain extent with respect to increase withholding rates and to the proposed capital gains tax, therefore, apply in full force here.

9. If anything like the proposed transfer tax should be accepted, it seems necessary (1) to provide for a higher rate of tax – such rate to be practically prohibitive on the export of American securities abroad, (2) to prohibit the use of street names not only for certificates to be exported but for domestic use, and (3) to stop the practice of beneficial owners claiming the dividends on certificates standing in street names from the nominee. This seems to be the only way to avoid driving foreigners' trading in American securities almost exclusively to foreign markets to the detriment of our securities markets and with the attendant loss of taxes to the Treasury. The difficulties in the way of such a prohibitive export tax and particularly its enforcement and of a prohibition of the use of certificates in street names are so tremendous that we would rather see the idea of a transfer tax as a medium of controlling the flow of foreign money abandoned altogether.

10. This proposal again emphasizes the necessity of obtaining more detailed information on transactions in American securities for account of foreigners, particularly with respect to the type of securities traded, the size of individual purchases and sales, the type of

foreign buyers and sellers, and the amount of American securities owned by foreigners held here and shipped abroad. Part of this information could be obtained rather easily by requiring detailed reports in place of the present summary reports made to the Treasury. The rest would require a sort of census for which all banks, brokers, etc. would have to list all American securities now held for foreign owners and all certificates representing American securities which they have shipped abroad or received from abroad since, say, the beginning of 1935. Our present knowledge of all these important facts is woefully inadequate to enable us to make intelligent decisions on the far-reaching proposals now under consideration.