You will recall that the so-called Maloney Act amendment to the Exchange Act (which, among other things, added section 15A to that act) was designed to provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers operating in interstate and foreign commerce or through the mails, comparable to that provided by National Securities Exchanges under the Securities Exchange Act of 1934. It came about as the result of cooperation between Senator Francis T. Maloney, the Securities and Exchange Commission, representatives of the investment banking and securities business and the deliberations and ultimate approval of your committee, and I think it is generally recognized as a highly significant and promising experiment in cooperative regulation by government and business.

More specifically, section 15A contemplates the formation of associations of brokers and dealers and their registration with the Securities and Exchange Commission for the purpose of providing such associations with effective means or sanctions to bring about self-regulation of association members, under governmental supervision. Such associations are thus enabled to promulgate and enforce, with Securities and Exchange Commission approval, such rules of fair practice as they deem necessary and appropriate to carry out the purposes of the act.

The National Association of Securities Dealers is the only association to date which has registered with the Securities and Exchange Commission pursuant to the provisions of said section 15A. Its registration statement became effective on August 7, 1939, at which time it had 1,469 members. Today it has 2,891 members, which are located in every State and in substantially every important city or town in the country, and it is believed that the present membership does well over 90 percent of the underwriting and general over-the-counter securities business of the country.

For purposes of administration, the country is divided into 14 districts, and each district elects a district committee which has general supervision and charge of the affairs of the association in its district. There is also a national board of governors of 21 members who are elected from the various districts, and the board of governors is the national governing body of the association.

The association has adopted some 25 rules of fair practice, and these are enforced by district and local business-conduct committees and by the board of governors.

In accordance with the provisions of section 15A of the Exchange Act, decisions of district business-conduct committees are appealable to the board of governors, from the board of governors to the Securities and Exchange Commission, and from the Securities and Exchange Commission to the Federal courts.

Section 15A gives such associations the right, by rule, generally to restrict the preferential dealings of members to members of such associations, and the National Association of Securities Dealers has adopted such a rule. In view, therefore, of the size and importance of its membership in the business, the fact that no other association has registered with the Commission, and the fact that a member expelled for violation of the rules may no longer deal with association members on a preferential basis, it can readily be seen that the association has effective economic sanctions for requiring compliance with its rules.

As I have already indicated, the association at present has 2,891 members, and since there are some 6,700 brokers and dealers registered with the Securities and Exchange Commission, it might be thought that the association covers only a part of the field to be regulated; but in this connection, I should like to call your attention to the fact that of the 6,700 brokers and dealers registered with the Commission, some 1,000 are largely brokers and dealers in oil royalties, and thus have no interest in membership in the association or in the provisions of S. 3580. By the same token, it is estimated that several hundred are dealers in real-estate mortgages and notes and some 700 are brokers or dealers who are solely connected with exchange trading; so that when the list of brokers and dealers registered with the Commission is thus broken down, I think it fair to say that only some 4,000 brokers and dealers can be said to be in the general over-the-counter securities business and thus interested in membership in the association or in the provisions of S. 3580. You will see, therefore, that roughly 75 percent of this 4,000 are already members of the association. Indeed, substantially all of the so-called open-end investment-trust underwriters are at present members of the association, and it is our belief that the vast majority of dealers who distribute shares of open-end investment trusts are already members of the association; so the association does afford an effective medium for

handling the regulatory problems which are sought to be reached by the provisions of S. 3580 insofar as they affect the underwriting and distribution of open-end investment-trust shares.

As a matter of fact, there is a standing committee of the Association of Investment Trust Underwriters which is charged with the duty of studying all aspects of the problem of underwriting and distributing shares of open-end investment companies with a view to formulating recommendations of appropriate rules and regulations, to be adopted as rules of fair practice of the association, governing this particular branch of the investment banking and securities business, and this committee is presently at work on the task assigned it and is hopeful of formulating a comprehensive regulatory program to be carried out through the association in the immediate future.

As the underwriting and distribution of shares of open-end investment trusts is after all an important branch of the general securities business; and as the Congress, on the recommendation of your committee, has already seen fit to provide for this mechanism of self-regulation, under governmental supervision, of this business, and as the National Association of Securities Dealers, Inc., has already registered with the Commission and is seeking to carry out the purposes of section 15A of the act, and as the investment trust underwriters and distributors are already proceeding through the association to develop a comprehensive regulatory program for their phase of the business, it is submitted that investment trust underwriters and distributors should be given a fair opportunity to effectively regulate their branch of the securities business through the Association as envisaged by the Maloney Act.

Very truly yours,

HUGH BULLOCK.

MAY 2, 1940.

Hon. ROBERT F. WAGNER,
Chairman, Subcommittee of the Committee on Banking and Currency,
Washington, D. C.

DEAR SENATOR WAGNER: During the hearings before your committee on S. 3580 the members of the staff of the Securities and Exchange Commission have minimized the effects of title II of this bill. In his rebuttal testimony on Friday, April 26th, in discussing this title Mr. Schenker made the following statements: "All we are asking them to do is file a piece of paper and say, Who are you? What's your name? What's your address? Have you ever been convicted of a crime? If you have been convicted of a crime, you have no business to be an investment counsel and you can't use the mails to perpetrate a fraud. That is the extent of this whole regulation on these people."

If this description could be regarded as a complete summary of the provisions of title II, it would indeed be difficult to see why the investment counsel profession is so seriously concerned about the effects of this bill.

Title II consists of more than 30 pages, over two-thirds of which are incorporated by reference from title I. Obviously no such long and complex bill is required to accomplish the purposes enumerated by Mr. Schenker.

In connection with the filing of the registration statement provided for in this bill and in addition to the information specifically mentioned in the text, the Commission is empowered to demand such further information and copies of such further documents relating to such investment adviser or its affiliated persons and employees as the Commission may by rules and regulations or order prescribe as in its opinion is necessary or appropriate in the public interest or for the protection of investors. This is hardly "Who are you? What's your name? What's your address? Have you ever been convicted of a crime?"

All of the enforcement provisions of title II are incorporated by reference from the title I. These provisions which were designed to meet the problems incident to the public's holdings of the securities of investment companies are thus transferred to cover the highly personal and confidential relationship existing between an investment counsel and his clients. They are not appropriate for this purpose, and they are more far-reaching than is necessary to accomplish the stated objectives of the Commission. Section 38 of the bill gives the Commission discretion and broad powers to investigate facts, conditions, and practices within our profession. These powers are not limited to the determination of whether a person has violated the law or is about to violate the law or to investigations in connection with the enforcement of the provisions of title II. Despite the broad scope of this bill, it contains no provisions to safeguard and

protect the interests of clients of investment counsel firms in the privacy of their affairs.

This letter is not intended to be a summary of our objections to title II of this bill. It is merely a statement of the more important reasons why we feel that Mr. Schenker's description of the effects of this title is not in accordance with its actual provisions as we read them.

We would appreciate having this letter printed as part of the record of the hearings before your committee.

Respectfully yours,

C. M. O'HEARN.
DOUGLAS T. JOHNSTON.
DWIGHT C. ROSE.
ALEXANDER STANDISH.
JAMES N. WHITE.

BOSTON, MASS., *May 2, 1940.*

Re: Investment company bill.

Hon. ROBERT F. WAGNER,
Chairman, Committee on Banking and Currency, Washington, D. C.

DEAR SIR: In accordance with the invitation of Senator Hughes on Friday, April 26, 1940, we wish to submit, with the request that it be included in the record, the enclosed statement.

Yours respectfully,

PAUL C. CABOT,
President, State Street Investment Corporation, Boston, Mass.
WM. TUDER GARDINER,
Chairman, Incorporated Investors, Boston, Mass.
MERRILL GRISWOLD,
Chairman, Massachusetts Investors Trust, Boston, Mass.

MEMORANDUM FOR THE RECORD OF THE SENATE BANKING AND CURRENCY COMMITTEE ON INVESTMENT COMPANY BILL S. 3580

On Wednesday, April 24, 1940, Mr. Schenker, testifying before the Committee regarding the tax treatment of mutual investment companies, said:

"I can state why, and I think I can state my difficulties with the tax discrimination. Unfortunately, Senator, there is no legislative history upon that provision in the tax law. As I remember it, it was introduced on the floor, and the first thing we knew was that the open-ended companies, as counterdistinguished from the closed-end company, had this tax preference."

The above statement is incomplete and we wish to correct it. In this connection, we have been told that Mr. Schenker will offer a correction of his testimony.

But inasmuch as reference to this matter has recurred from time to time, both at this hearing and prior thereto, and in order that the facts may be fully known, we wish to give herewith a brief history of that phase of the tax legislation.

In his Message to Congress on June 19, 1935, the President of the United States recognized that bona fide investment trusts that submit to public regulation and perform the function of permitting small investors to obtain the benefit of diversification of risk should receive special tax treatment.

As a result of this statement, late in 1935 and early in 1936 a group representing a large number of open-end companies had conferences with many individuals in the Treasury Department, with various Senators and Representatives and the President of the United States, relative to tax relief for investment companies. The more important of these interviews will be detailed below.

Prior to any of these conversations, Paul C. Cabot had an interview with Mr. James Landis, then Chairman of the Securities and Exchange Commission, in which Mr. Cabot outlined to the Chairman what specific tax relief this group sought and solicited the Commission's aid in respect thereto. In substance, Chairman Landis at this time stated that in view of the fact that the Securities and Exchange Commission was about to undertake an exhaustive study

of the investment trust industry, he felt that it was inadvisable for the Commission to initiate any attempt to change tax legislation in favor of or in opposition to investment companies. He did state, however, that he would be interested in knowing what, if anything, was accomplished along these lines. Because of this, the group kept Mr. Landis' assistant, Mr. Thomas H. Gammach, informed as to their procedure from time to time.

On June 12, 1936, the group met with Mr. Milton Katz, executive assistant to the Chairman, and related to him in detail what had transpired. At that time, Mr. Katz wrote a memorandum under date of June 12, 1936, a copy of which is hereto appended, marked "Exhibit A," which was marked to go to Chairman Landis, Mr. Schenker, and Dr. Gourrich.

On March 16, 1936, Merrill Griswold wrote President Roosevelt, urging that the taxation problems of investment trusts be most carefully considered in connection with the proposed new revenue bill. In the course of his letter, he said: "The Securities and Exchange Commission is at present making a thorough study of investment trusts and is consequently already reasonably thoroughly familiar with their taxation problems. I venture to suggest, therefore, that the views of the Commission be ascertained by the administration and by Congress as to how the interests of the shareholders of investment trusts can best be reconciled under the new law with the interests of the Government."

In reply, the President's secretary, Mr. Gaston, wrote Mr. Griswold that Mr. Morgenthau had asked those of his associates who were particularly studying the type of problem described to read the material submitted very carefully and to consider it in connection with other suggestions that were under discussion.

On March 11, 1936, an interview was requested with Mr. Guy T. Helvering, Commissioner of Internal Revenue, and under date of March 18 this interview was arranged for March 25. From Mr. Cabot's letter of March 11, we quote the following:

"I am most anxious to have an opportunity for a personal interview not only to go over the subject of my previous correspondence relative to section 102 of the Revenue Act of 1934, but also to present to you certain ideas relative to future taxation which have been brought about by the President's recent message."

On March 24, 1936, an interview took place with Messrs. L. K. Sunderlin, Hill, and McGinnis of the Department of Internal Revenue.

Under date of May 18, 1936, a letter was written by Mr. Cabot to Mr. C. E. Turney of the Treasury Department, from which we quote the following:

"Since that time I have had a very satisfactory talk with Messrs. Sunderlin, Hill, and McGinnis of the Internal Revenue Department. In talking with these gentlemen I had occasion to enter into a discussion with them as to the then pending House revenue bill (H. R. 12395) and left with them a memorandum, copy of which I am enclosing marked 'Exhibit A.' At their suggestion I also had at that time a talk with Mr. L. H. Parker, Chief of Staff of the Joint Committee on Internal Revenue Taxation, and left with him also a copy of exhibit A.

"As a result of these conversations we drew up certain Suggestions Regarding Treatment of Mutual Investment Trusts and Corporations under Revenue Bill of 1936, H. R. 12395, a copy of which is enclosed marked 'Exhibit B.'[1]

"About a week ago Mr. Griswold and my partner, Mr. Morton, were in Washington relative to these suggestions and at that time discussed the matter with Mr. Parker and various Senators on the Finance Committee; also with Messrs. Harlan, Brown, and Oliphant."

On Friday, May 8, 1936, Senator Walsh of Massachusetts introduced before the Committee on Finance of the United States Senate the memorandum hereto appended, marked "Exhibit B." (See Hearings Before Committee on Finance of United States Senate, H. R. 12395. U. S. Government Printing Office Publication No. 68545, p. 799.)

Under date of May 23, the memorandum above referred to marked "Exhibit B" was supplemented by a statement (herewith attached and marked "Exhibit C"), from which it will appear that we did not claim or urge that our proposal be limited to companies only that had redeemable shares.

On Tuesday, May 26, 1936, we had an interview in Senator Walsh's office

[1] Suggestions Regarding Treatment of Mutual Investment Trusts and Corporations under Revenue Bill of 1936, H. R. 12395, is hereto appended as exhibit B.

with Messrs. Lusk and Kent, of the Bureau of Internal Revenue, relative thereto.

During this entire period there were many conversations held with Senators and Representatives, and on June 3, 1936, the undersigned had an interview with the President relative thereto.

On June 5, 1936, Senator Walsh offered in the Senate certain amendments which he stated that the subcommittee had unanimously agreed upon (Cong. Rec., p. 9070). Such of these amendments as related to the taxation of mutual investment companies were adopted by the Senate and subsequently, with minor changes, made by the Conference Committee (which reported June 19, 1936), were enacted into law.

On June 12, 1936, as above-mentioned, the entire matter was taken up again with the Securities and Exchange Commission who at that time wrote the memorandum (exhibit A) appended hereto.

On October 19, 1937, the entire history as above-mentioned was again gone into in considerable detail in an interview by the undersigned with Commissioner Healy in his office, into which he called Messrs. Schenker and Gourrich.

On September 23, 1936, Mr. Paul C. Cabot, in his public testimony before the Securities and Exchange Commission, went into the subject of the Revenue Act of 1936, as it affected mutual investment companies, in great detail.

To complete the history of this tax matter, brief reference should be made to the 1938 Revenue Act.

The Vinson subcommittee of the Committee on Ways and Means transmitted their report on January 14, 1938. Recommendation No. 5 covered "mutual investment companies." (See pp. 10 and 66 of that report.)

Representatives of open-end and closed-end investment companies appeared at hearings before the Committee on Ways and Means on the bill that became the Revenue Act of 1938 (see pp. 809 and 827 of the record of hearings). Representatives of the Securities and Exchange Commission also appeared prior to passage of the bill, but at some executive session. The 1938 act provisions appear in section 361.

In view of all the above, we believe the remarks made by Mr. Schenker as quoted above are incomplete; that there was considerable legislative history upon this tax provision, and that the Securities and Exchange Commission were fully informed by us about it from start to finish.

PAUL C. CABOT,
President, State Street Investment Corporation, Boston, Mass.
WM. TUDOR GARDINER,
Chairman, Incorporated Investors. Boston, Mass.
MERRILL GRISWOLD,
Chairman, Massachusetts Investors Trust, Boston, Mass.

EXHIBIT A

JUNE 12, 1936.

Chairman Landis, Mr. Schenker, and Dr. Gourrich. Mr. Katz. Conversation with Messrs. Paul Cabot, Merrill Griswold, and W. T. Gardiner concerning "mutual investment companies"

Mr. Paul C. Cabot, president of the State Street Investment Corporation; Mr. Merrill Griswold, chairman of the Massachusetts Investors Trust; and Governor W. T. Gardiner, chairman of Incorporated Investors, are in Washington in connection with pending deliberations upon the tax bill. Their specific concern is with the impact of the bill upon investment trusts of a type hereinafter described, which they call "mutual investment companies." The character of these companies is best indicated in the definition of "mutual investment company" set forth in proposed section 1001 (15), a copy of which is attached hereto.

Under the terms of the original House bill, earnings paid out would not have been taxable except in the hands of the recipients. In consequence, this bill involved no serious problem for the mutual investment companies. It would merely have required them to pay out capital gains as well as income upon the securities in the portfolio, to earmark the capital gain as such, and to solicit reinvestment of the capital gain by the shareholders.

The Senate bill, however, as originally conceived, would have placed a very serious burden upon these companies by reason of its imposition of an income tax ranging up to 18 percent upon the income of the company, as well as the normal tax upon dividends paid by the company to its shareholders. (The Senate

bill, of course, imposed a 7-percent undistributed-earnings tax, which could have been avoided by distribution of the earnings.)

The Senate bill, as passed, however, contains a special provision for mutual investment companies as defined therein. This provision would enable such companies to deduct from taxable income all (or a very substantial part) of the earnings paid out to shareholders. The attached section 1001 (15) represents a modification of the definition of mutual investment companies, worked out by Messrs. Cabot, Griswold, and Gardiner with technicians at the Treasury. They hope that the modification will be embodied in the bill by the conference committee.

An interesting question that arises out of the provisions in the proposed bill is whether they will cover the situation of fixed investment trusts. Mutual investment companies, as defined, can avoid the tax only by paying out all earnings, including capital gains. The ordinary type of fixed trust does not have authority to pay out capital gains, and there is some question whether, in the ordinary case, they can conveniently amend their articles so as to make such payment lawful. I was informed that the Treasury expressed some concern over this question, and that Mr. Griswold suggested Dr. Gourrich as a source of information. It should be noted that the question may not be particularly serious for fixed trusts, inasmuch as changes in their portfolio do not occur often.

Exhibit B. Suggestions Regarding Treatment of Mutual Investment Trusts and Corporations under Revenue Bill of 1936, H. R. 12395

INTRODUCTION

The two Boston mutual investment trusts signing this document merely constitute a conduit through which 40,000 persons residing in practically every State in the Union have made investments in stocks of about 130 different corporations. Over a period from 1924 to date these 40,000 people have invested about $120,000,000 in these funds, the average investment being about $3,000 apiece. This $120,000,000 as of March 31 was worth approximately $140,000,000. Most of the shareholders are persons of moderate means, either not in the surtax brackets or else in the lower tier of such brackets, who do not have equal facilities with the wealthy to obtain expert supervision and diversity in their investments. It is in order to obtain these benefits that they have availed themselves of these funds which guarantee to redeem all or any part of their shares at any time at a price approximately equal to the liquidating value per share, which price of course varies from day to day with changing market conditions.

We, the managers of these funds, are anxious that any new tax bill shall not create any injustice to our shareholders and that so far as is possible it remedy existing inequities.

If investment corporations and investment trusts (which for taxation purposes are classed as corporations) provided they distribute their entire taxable income, are taxed under the new bill in effect the same as partnerships, the result on the shareholders will be fairer than under the present law. The present law is particularly unfair to shareholders of moderate means, who are not subject to surtax. Under existing law these people are today forced through their corporations to pay in taxes at the rate of at least 15 percent on gains, although if they had made the same gains directly as individuals, they only pay 4 percent. In the words of the Secretary of the Treasury, Mr. Morgenthau, on April 30 before the Senate committee "it will be well to bear in mind at all times that this is purely and simply a proposal to put all taxes on business profits essentially on the same equitable basis; to give no advantages and to impose no penalities upon corporation stockholders that are not given to and imposed upon the individual taxpayer."

If the partnership theory is adopted exactly (and to do this section 117 of the proposed bill must be slightly amended as hereinafter set forth), although the Government will receive increasing revenues from the shareholders of investment trusts, individual shareholders cannot complain as they will be equitably treated—whether subject or not to surtaxes. If, on the other hand, instead of adopting the partnership theory the flat rate on investment trusts, now 15 percent, is substantially increased and/or the present allowance for deduction of dividends, which is now 90 percent, is decreased, the existing inequities will be even further accentuated. Therefore, regardless of the merits or the demerits of the proposed bill in its effect in the general economy

and on ordinary business corporations, we urge that in any event the provisions of the new bill substantially as proposed be retained for mutual investment trusts subject only to modifying section 117.

SECTION 117

Section 117 provides that in the case of a taxpayer other than a corporation, only the following percentages of gain or loss recognized upon the sale or exchange of capital assets can be taken into account for computing net income: 100 percent of the capital which has been held for not more than 1 year, 80 percent if for more than 1 year but less than 2 years, 60 percent if for more than 2 years but not more than 5 years, 40 percent if for more than 5 years but not more than 10 years, 30 percent if for more than 10 years.

Investment trusts, probably more than any other kind of corporations, are vitally concerned with the method of taxing gains, as frequent changes in their portfolios are made which in all cases result in either capital gains or losses. In the case of ordinary business corporations, not considering for the moment investment trusts, insurance companies, and possibly banks, it is reasonable to assume that almost the entire taxable income is derived from ordinary taxable income distinct from capital gains. Therefore, if the words "other than a corporation" are stricken from this section there will be little loss in revenue so far as ordinary business corporations are concerned. Banks and insurance companies are not so much concerned with section 117, as under the proposed bill they are taxed in a special manner different from ordinary business corporations. This leaves investment trusts as the primary class of corporate taxpayer who are concerned with section 117. Under the proposed bill the high tax rates will force investment trusts to distribute at the end of each year all or substantially all of the taxable profits realized on the sale of capital assets. If the shareholders of investment trusts are to be treated as if they were partners who are merely banded together for the purpose of obtaining diversity and expert supervision and use the investment trust merely as a conduit for such a purpose, then in all fairness these shareholders who for the most part are of limited means, should have accorded to them the same relief relative to capital gains as is now provided wealthy individual taxpayers and partnerships. This would be in accordance with the spirit of Mr. Morgenthau's remarks quoted above, and can be accomplished by amending section 117 by striking out the words "other than a corporation." This we advocate. This will diminish the unfair advantage possessed by the wealthy who are able to set up individual trusts managed by private trustees or by banks and which peerform the same function that investment corporations perform for persons of limited means.

OBJECTIONS ANSWERED

It has been pointed out that investment trusts will under the terms of the new bill be forced to distribute to their shareholders all or substantially all of their net taxable income including taxable profits realized on the sale of capital assets and that this procedure is economically unsound for two principal reasons. First, that such distribution in times of prosperity will leave an insufficient amount in the treasury of the trust with which to meet the inevitable losses of periods of depression and, second, that it will give to shareholders, particularly those who are of moderate means and less well informed as to financial matters, an erroneous impression as to the probable recurrence of large dividends, and therefore lead to the dissipation of these dividends rather than the saving of them for expenses during the periods of depression.

We feel so far as investment trusts are concerned that although this is a valid objection it can largely if not entirely be met by taking advantage of section 115. Section 115 provides that whenever a distribution is at the election of any of the shareholders whether exercised before or after the declaration thereof, payable in stock of the corporation or in money, the distribution shall constitute a taxable dividend in the hands of the shareholders regardless of the medium in which paid.

This points the way for investment trusts at the close of each taxable year to declare special dividends out of capital gains which as a matter of policy we presume properly operated investment trusts will clearly designate as declared from such gains rather than from regular income and give the shareholders the right to accept in payment of such special dividends additional shares of the investment trust itself. In our case, at any rate, if this procedure were followed, no load or commission would be charged incidental with the reinvestment of

such capital gains. Indeed, it might be advisable to offer these shares at a discount well below liquidating value. In view of the fact that the shares of such trusts as ours are redeemable at approximately liquidating value at any time, we anticipate that our shareholders generally would exercise their election in favor of taking additional shares instead of cash, and that therefore the uneconomic circumstances above referred to would be dispelled.

To emphasize our suggestions, we therefore urge—

1. That section 117 be amended by striking out the words "other than a corporation."

2. That regardless of whether the partnership theory is adopted for ordinary business corporations generally that in any case it be adopted for mutual investment trusts such as the type of trust represented by the undersigned.

PAUL C. CABOT,
President, State Street Investment Corporation.
MERRILL GRISWOLD,
Chairman of the Board, Massachusetts Investors Trust.

EXHIBIT C

STATE STREET INVESTMENT CORPORATION,
Boston, Mass., May 23, 1936.

DEAR SIR: We recently sent you a memorandum entitled "Suggestions Regarding Treatment of Mutual Investment Trusts and Corporations Under Revenue Bill of 1936, H. R. 12395," also copy of letter under date of May 13 on the same subject.

Briefly, the first of these memoranda pointed out that so far as investment trusts were concerned, the effect of the House bill, provided it were slightly amended by giving the benefits of section 117 to investment corporations and thereby treating them on the same basis as individuals or partners, was fair and equitable and corrected the present situation which heavily penalized individuals of small means who are forced to use investment trust corporations as a conduit for their savings in order to obtain diversification and expert supervision.

Since submitting this memoranda it has, according to press reportes become obvious that the Senate Finance Committee will largely redraft the House bill and is proposing to retain, in fact increase, the corporate levies and add thereto a 7-percent tax on undistributed income of corporations. This, of course, merely aggravates the already unequitable situation as regards the individual of small means and, in the words of President Roosevelt, we feel that "bona fide investment trusts that submit to public regulation and perform the function of permitting small investors to obtain the benefit of diversification of risk, may well be exempted from this tax."

We are therefore submitting herewith two methods which in substance will result in the same effect whereby the original provisions of the House bill will be retained at least so far as investment trust corporations are concerned. It has been pointed out that if the exact partnership theory were applied, there would be almost insuperable difficulties as to method and technique to overcome. In reverting, therefore, to the theory of the House bill for investment corporations, we are maintaining the original principles as laid down by the President in his message to Congress and assure—

1. That investment corporations that do not pay out any of their income will be taxed at rates equal to those under the proposed Senate bill, i. e., 25 percent;

2. That those investment corporations distributing only a part of their income will pay a tax at least equal to the proposed Senate rates and in some instances more:

3. Where an investment trust pays out all its income, including gains, there will be no tax to the corporation as such, but the dividends will be, of course, subject to normal taxes and surtaxes in the hands of the individual recipients.

In other words, the net effect will be a strong incentive for the complete distribution to shareholders of the total income, thereby greatly increasing the taxable income of the individual shareholders. It will, therefore, greatly minimize the ability of rich individuals to evade surtaxes and at the same time will relieve the individual of small means from the unfair burden of taxes that he is today paying through his investment corporation.

You will note that in the specific suggestions the definition of an investment trust is broad and does not limit the category to "mutual investment corporations." Were this deemed to be advisable, we would add the following to the definition as submitted: "*Provided further*, That it shall apply only to corporations each shareholder of which, upon reasonable notice and under reasonable conditions, is entitled to withdraw his share of the corporation property or its equivalent in cash."

STATE STREET INVESTMENT CORPORATION,
By PAUL C. CABOT, *President*.

SUPPLEMENTARY STATEMENT FILED BY ARTHUR H. BUNKER, MAY 3, 1940

In testimony given before this committee on April 24, 1940, Dr. Raymond W. Goldsmith and Mr. Lawrence C. Vass of the staff of the Securities and Exchange Commission made certain criticisms and comments upon testimony and supporting statistical studies submitted by me to the committee on April 12, 1940. At the close of the hearings on April 26, I stated that I reaffirmed in all respects the accuracy of the testimony which I had previously given, and I asked and was courteously accorded the privilege of filing for the record a supplementary statement. The following statement is filed pursuant to that permission. It deals not only with the criticisms of Dr. Goldsmith and Mr. Vass but with certain testimony given by Mr. L. M. C. Smith on April 23.

First, as to Dr. Goldsmith's testimony, his remarks had to do primarily with the passage in my testimony of April 12 wherein I cited the apparent discrepancy between the statement—first made before the committee by Judge Healy in his opening remarks on April 2 and subsequently repeated directly and by inference—that "investors have sustained a capital shrinkage of approximately $3,000,000,000 in all types of investment trusts and investment companies," and two passages from House Document No. 70, pages 184 and 187, which I cited, as follows:

"It is, therefore, estimated that the grand total of sales of securities by investment companies of all types from their inception in this country up to the end of 1937 was approximately $7,200,000,000.

"During the years 1927 to 1936, investment trusts and investment companies repurchased or redeemed approximately $1,200,000,000 of their own securities, valued on the basis of cost to the trusts and companies. If these repurchases be deducted from the value of sales of investment company issues which represents total monies contributed by the public to investment companies, then the net public contribution would be approximately $5,300,000,000 during the years 1927 to 1936, and about $6,000,000,000 during the entire existence of these trusts and companies up to the end of 1937."

I then raised the question as to how the alleged shrinkage could have been as large as $3,000,000,000 at a time when the assets of the industry were worth $4,000,000,000.

Now, as a matter of fact, I was entirely correct in raising this question, because at the time when the assets of the industry were worth about $4,000,000,000, namely, at the end of 1936, the total shrinkage was about $1,500,000,000 and not the $3,000,000,000 that is stated by Dr. Goldsmith. The difference between this figure of $1,500,000,000 and the $3,000,000,000, as determined by Dr. Goldsmith, is to be accounted for in a very simple manner. In the first place, Dr. Goldsmith has throughout made the mistake of including $383,000,000 of capital appreciation as "money originally paid by investors to the investment companies for their securities." Therefore, this amount must be used to reduce all losses calculated by Dr. Goldsmith. Further, he has seen fit to discuss the year 1935 instead of 1936, the difference being that the assets of the investment companies were less by $1,070,000,000 at the end of 1935 than they were at the end of 1936. The sum of these figures is almost $1,500,000,000.

Dr. Goldsmith could have thrown some useful light on this problem which seemed a source of constant confusion throughout the hearings. Instead, he concludes: "So, notwithstanding Mr. Bunker's impression, the capital loss is $3,000,000,000.

Now if Dr. Goldsmith were to make a calculation for a period 1 year later—the period to which I was referring—he would have to arrive at the same figure of $1,500,000,000, as I have used exactly the same procedure in