[CONFIDENTIAL]

REVENUE ACT OF 1938

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

SEVENTY-FIFTH CONGRESS

THIRD SESSION

ON

H. R. 9682

AN ACT TO PROVIDE REVENUE, EQUALIZE TAXATION AND FOR OTHER PURPOSES

PART 4

MARCH 30, 1938

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REVENUE ACT OF 1938

WEDNESDAY, MARCH 30, 1938

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to adjournment, at 9:30 a. m., in the Finance Committee room, Senate Office Building, Senator Pat Harrison (chairman) presiding.

STATEMENT OF WILLIAM O. DOUGLAS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. DOUGLAS. Mr. Chairman, under section 11 of the Public Utility Holding Company Act, our Commission has two major jobs that now lie ahead, in view of the decision the other day by the Supreme Court upholding the constitutionality of the registration provisions of the statute. Those two jobs are, generally speaking, first, corporate simplification, and, second, geographical integration of utility properties.

The corporate simplification problem is, generally speaking, one designed to eliminate those tiers upon tiers of companies that we find in many of the holding-company systems. The standard in the statute is, speaking broadly, this, that a holding company may have some children, and it may have some grandchildren, but it may not have great-grandchildren or relatives of an even more distant relationship. That means, in many of these situations, eliminating one company, two companies, three companies, or four companies, the design of Congress being to bring the security holders of the holding company closer to the real values in the operating companies. The problem under the integration provision of section 11 is to bring these properties into compact units, properties that are contiguous, operating in one or more States, rather than the scattered types of properties that you find in many systems. Now those are the standards that Congress has given us to apply, corporate simplification and geographical integration.

There are two ways of doing it under the statute: One is to have the companies themselves come in with their own voluntary plans under section 11 (e). Another way of doing it is for the Commission, by the procedure outlined in the statute, to effect those objectives or reach those objectives by orders that it enters itself. That is compulsory in form and in effect.

Our Commission has adopted the general policy of working with the industry, running our Commission on the basis of a service sta-

tion, trying to get the industry to do these things under its own motive power, and we have been successful, I may say, to date in that objective, and the temper of the industry today is one of working in cooperation with us.

The first order that we entered under section 11 was in the case of American Water Works last December, where American Water Works worked out its plan under the aegis of the Commission, and where we approved the regrouping and the corporate-simplification program. We think, by and large, that will be the pattern that these companies will follow, namely, one of voluntary action. Nevertheless, even though that is the procedure that we think and hope they will follow, namely, doing the thing that Congress has said that they should do under their own motive power, we cannot blink the fact that they are doing it as the result of a congressional mandate. That is, they are not doing it just as a matter of managerial discretion, they are doing it because Congress has said, "You must simplify your corporate structure and you must integrate geographically your operating properties." So even though the particular plan is voluntary in form, it is, in essence, compulsory.

The CHAIRMAN. In view of the Supreme Court decision Monday you think it would be motivated more, do you not?

Mr. DOUGLAS. The Supreme Court did not pass upon the constitutionality of this section that I am speaking of, section 11, but it did uphold the registration provisions of the act, which means that the companies must come in. The big job for them to do once they come in is, first, corporate simplification, and, second, geographical integration.

Now, Mr. Chairman, it is our view that since the Government is, in effect, telling these people that they must do this, even though the doing of it may be voluntary in form——

Senator BAILEY. If they did not do it you will do it for them. You have a gun on them.

Mr. DOUGLAS. Yes. We are responsible to the Congress, and if they did not do it we have to do it. That is our job.

Senator BAILEY. It is compulsory?

Mr. DOUGLAS. It is compulsory even though it is voluntary in form.

Senator CONNALLY. Your theory is it would be less painful if they do it the way they wanted to do it than it would be if you rammed it down their throat?

Mr. DOUGLAS. Yes; there is no question but what the brains that built up those crazy hierarchies of utility holding companies can do a constructive job in reducing them to a more simple pattern, along the lines set by Congress for them to follow, and bring the whole private utility industry into greater order and stability, in line with conservative practices, and so on. There is no question but what the brains are there to do it, and I think there is the desire, by and large, for them to go ahead. The ice jam is out, in other words, and there is every indication that they want to go ahead and do the job in a constructive way.

Senator KING. I was about to ask you, Is there any purpose to reduce the unit to very small units so that probably they could not operate as efficiently as if the geographical field was a little larger? I have in mind a case where the power comes over a long distance,

probably over the mountains, and it would not be very near geographically, and yet the power can be obtained from that and other more distant sources cheaper than the source at a nearer point.

Mr. DOUGLAS. All of those engineering points come into it. It is a question of integration, turning in part on the question of efficiency, the state of the art, and so on, as Congress has set up under section 11 (b). But, Mr. Chairman, since this is a compulsory transaction that they are going to be engaged in from now on, it does not seem to us fair and equitable for the Government to force them to do this and at the same time to collect taxes as the result of their doing it. So we are here this morning, Mr. Chairman, suggesting to the committee that some modifications of the capital-gains tax as respects such transfers be considered by the committee for immediate enactment into the law. Now that the ice jam, so to speak, has gone out, our big job at the Commission is to put the private utility house in order. We think we can do it, and we think we can do it expeditiously and constructively if this tax barrier is removed.

Now, specifically, that comes down to this, summarized generally: This is not just lifting, willy nilly, the tax on capital gains from these companies. It is a recommendation that where our Commission has entered an order under section 11, either in pursuance of a voluntary plan or as the result of an involuntary plan, Congress avoid thrusting on them—as the result of the doing of the thing that is embraced in that order—certain taxes otherwise not payable. That does not mean that if we collapse an intermediate holding company and require those securities to be distributed to the top company, that there will at no subsequent time be any payment of a tax; but it means that that collapse and that transfer which is effected under our order is not taxable and that the tax base, generally speaking, is substituted or, in some instances, transferred into the hands of the transferee, who later, in case of a noncompulsory transaction, does pay the tax. In other words, it is a rather narrow exemption, just for those immediate transactions that are effected as the result of the order that the Commission entered.

Senator BARKLEY. This exemption is insulated then, in a sense, to the actual transfers made necessary by the order of the Commission for which you speak?

Mr. DOUGLAS. That is right.

Senator BARKLEY. It has no relation to past or future transactions?

Mr. DOUGLAS. That is right. The basis is either substituted or transferred into the hands of the transferee, and in case of a subsequent noncompulsory transfer by him, then the tax statute, as presently written, comes into play. We down at the Commission do not desire to put the gun at the head of a utility company and say, "transfer these," and then to have another branch of the Federal Government collect $2,000,000, or $1,000, or $250,000 as the result of doing what we are forcing it to do.

Now, this proposed amendment has been worked out by the legislative counsel; some of our men sat in on the conferences that led to the drafting of it; some of the representatives of the Treasury, I believe, were also there. I can, if you like, Mr. Chairman, just touch some of the high spots on this.

(The amendment referred to by Mr. Douglas will be found at the end of his testimony.)

The CHAIRMAN. I wish you would.

Senator KING. How do you deal with the losses?

Mr. DOUGLAS. There is no recognition of gain or loss.

Senator KING. I would imagine there would be considerable paper values or losses in this compulsory or voluntary reorganization.

Mr. DOUGLAS. There is no recognition of either gain or loss.

The CHAIRMAN. This amendment that is now being distributed is the outcome of many conferences between your organization, the experts of the Commission, and the Treasury officials sitting in?

Mr. DOUGLAS. Yes; that is correct.

The CHAIRMAN. And the Treasury officials have looked over it and are thoroughly familiar with it?

Mr. DOUGLAS. The Treasury officials have looked over it. I have not had a chance to talk with Mr. Magill since he has seen it, but the staff of the Treasury, or some of the staff of the Treasury, I know were in on the conferences. I do not purport to speak for anybody but the Commission this morning.

The CHAIRMAN. All right.

Senator TOWNSEND. Have you estimated what it will do in the way of taxes—what effect it will have on the collecting of taxes?

Mr. DOUGLAS. That is rather difficult for us to estimate. I would not believe, however, that this source of taxes was ever computed or was ever figured upon. I mean I think if the taxes did roll in it would be more or less of a windfall.

The CHAIRMAN. But it has not been estimated by the Treasury as part of the Budget.

Senator BARKLEY. Well, it is not a tax that has ever been collected heretofore in identical terms, therefore there would be no loss, appreciable loss, as compared to previous collections on transfers, would there?

Mr. DOUGLAS. Well, there has never been, Senator, a situation comparable to this.

Senator BARKLEY. There may have been some transfers made in due course of business, but they are so inappreciable that we need not consider them?

Mr. DOUGLAS. Yes; and if they are made in due course of business under this proposed amendment they would still be taxable. The test of exemption is the presence of an order of the S. E. C. under section 11. There is one further qualification to that: The original order under this proposed amendment must have been entered by the Commission prior to January 1, 1940.

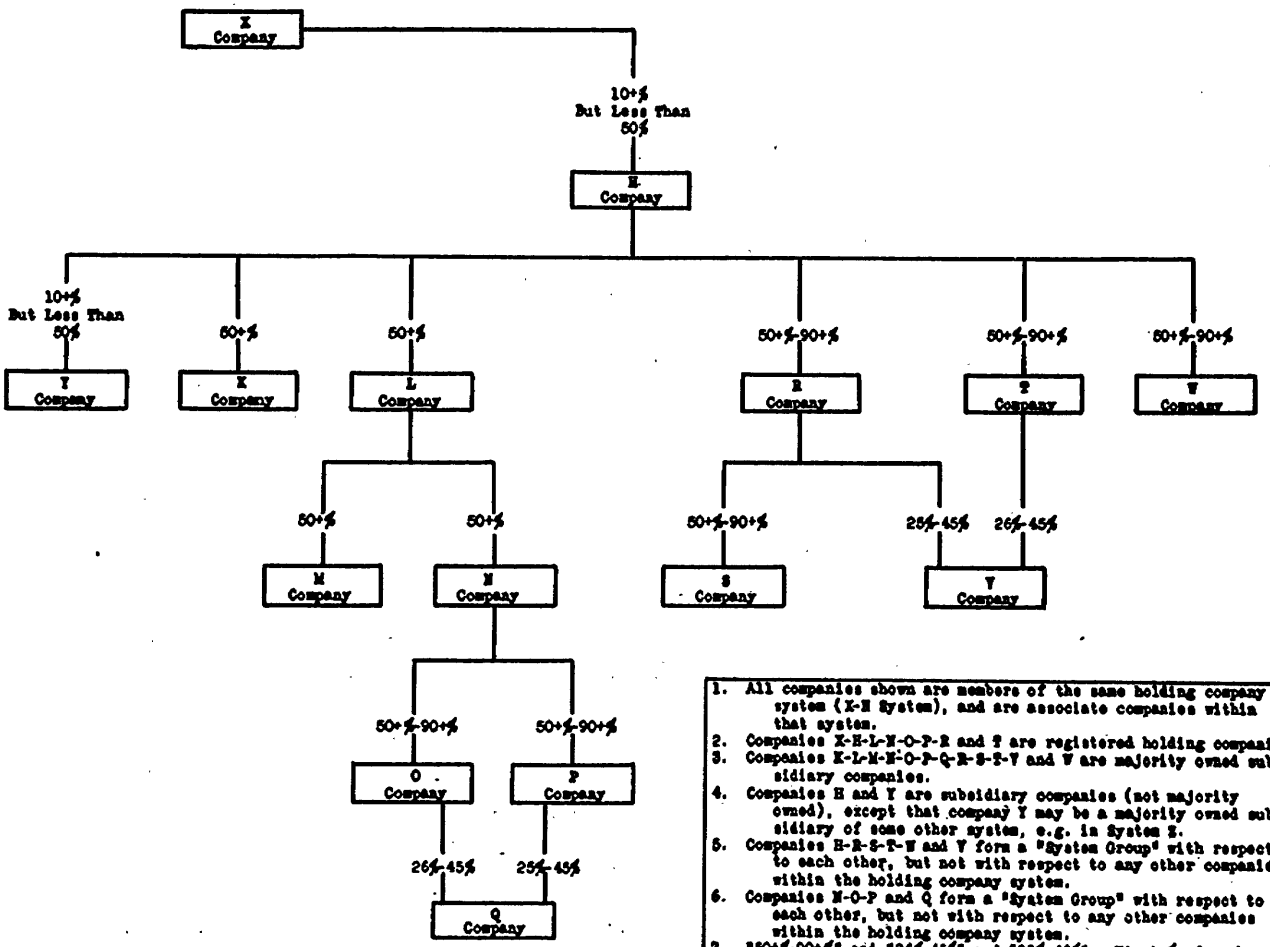
Senator KING. 1940?

Mr. DOUGLAS. 1940. In other words, we are looking forward to a period of less than 2 years where we think the major job will be done, so this is for a limited period of time, specifically addressed to the section 11 problem where the Commission itself has entered an order. Administratively, if the Congress adopted this amendment, we would operate closely in cooperation with the Treasury so that we would make certain that our order was not being abused by the industry.

Senator CONNALLY. The only companies that applies to is utility companies?

Mr. DOUGLAS. Yes. This is just an order entered under the Public Utility Holding Company Act.

ILLUSTRATIVE PUBLIC UTILITY HOLDING COMPANY SYSTEM



1. All companies shown are members of the same holding company system (X-E System), and are associate companies within that system.
2. Companies X-E-L-N-O-P-R and T are registered holding companies.
3. Companies K-L-M-N-O-P-Q-R-S-T-V and W are majority owned subsidiary companies.
4. Companies E and Y are subsidiary companies (not majority owned), except that company Y may be a majority owned subsidiary of some other system, e.g. in System Z.
5. Companies E-R-S-T-W and V form a "System Group" with respect to each other, but not with respect to any other companies within the holding company system.
6. Companies N-O-P and Q form a "System Group" with respect to each other, but not with respect to any other companies within the holding company system.
7. "50+%-90+%" and "26%-45%" and "25%-45%" - First % of each combination represents voting control and last % represents amount of residual equity which is owned.

Senator CONNALLY. You do not say so. This amendment does not appear to restrict it to utility companies. Of course you have no authority in any other case, except utility companies.

Mr. DOUGLAS. On page 5, line 17, the term "order" means an order entered under section 11 of the Public Utility Holding Company Act.

Senator CONNALLY. Well, on page 1 you say, "the exchange is made by the transferee corporation in obedience to an order of the Securities and Exchange Commission."

Mr. DOUGLAS. An "order" is defined on page 5 as an order under section 11. We enter all sorts of orders, but it would only be applicable to that type of order.

Senator BARKLEY. Could not this amendment be worked out with less language? It seems very simple.

The CHAIRMAN. The experts certainly tried to get it as simple as they could. They have been working on it for 2 or 3 weeks.

Mr. DOUGLAS. Now there are a few high points in this, which are purely illustrative, that I can run through, Mr. Chairman.

Under subparagraph (A) there are covered exchanges by holders of securities in a registered holding company or a majority-owned subsidiary thereof, where such securities are surrendered or exchanged for any other securities. The purpose of this subparagraph is to facilitate the elimination of these useless companies, or companies that under the standard of the statute are not permitted to remain.

Now, take a case on this chart where subholding company L down there on the lefthand side of the page is going to be eliminated. That is a subsidiary of H. Now, one way of eliminating that would be to have H make an offer to the public security holders of L, that is the members of the public who hold securities in L, to exchange those securities in L that they own for securities that H has, so as to get the public out. With the public out, L, all of whose remaining securities are held by H, could then be collapsed. That is one simple, normal way of doing it, and we have done something of that kind already.

Senator VANDENBERG. I wish you would get some word besides "collapse." It makes me nervous.

The CHAIRMAN. The thing that would be collapsed is the transfer which would be made?

Mr. DOUGLAS. It would go out of existence.

Senator BARKLEY. You could use "disintegration," but that is harder to pronounce.

Mr. DOUGLAS. Under existing law there would be no exemption for the security holder making the exchange. The entire amount of his gain would be recognized—I am speaking of the security holder of L—and would be measured by the difference between the fair market value of the securities received and the tax basis, in most instances his cost, of the securities surrendered.

Under the proposed amendment neither any gain nor loss is recognized to the shareholders of L unless they have received, in addition to securities, something like cash; that is, cash or its equivalent.

The CHAIRMAN. In that case what happens?

Mr. DOUGLAS. In that case they are taxed to the extent that they receive cash, to the extent of the boot received. That is the general

principle that runs all the way through here, with one exception that I will come to.

Assuming just an exchange of a security for another security, these security holders of L are being shoved, so to speak, by mandate of law from one investment situation into another investment situation, and there is attached to the new securities that they receive the basis of the old securities that they held. But as the result of that transfer they are not forced to pay taxes.

Senator KING. What becomes of the poor little tidbit way down in Q? Does he get anything? Do those people that have any stock or securities get anything?

Mr. DOUGLAS. Well, he is a little closer to the real values than the fellows way up at the top in most of these situations.

Senator CONNOLLY. He is in the operating company, and that is the only sound outfit in the whole business.

Mr. DOUGLAS. Now, under subparagraph (B) we have a more general provision that covers exchanges of property by registered holding companies or their associate companies for other property, regardless of the ownership of such other properties.

Now, as one illustration, take company X up there at the top. It may be desirable to eliminate company X from that system; company H, the next company down, might make an offer to company X in return for those 10 percent of the H securities owned by X to deliver to X other securities that H has in its portfolio. That eliminates X as a holding company. By definition, a holding company is a company that owns 10 percent or more of the voting securities of another utility company. X is therefore eliminated in pursuance of the program of corporate simplification.

Now, under the existing law, as I read it, there would be no gain recognized to H because it would be merely retiring its own stock, but X would have a recognized gain equal to the difference between the fair market value of the securities received and the tax basis of the H securities surrendered.

Under the proposed amendment no gain or loss would be recognized to either X or H except to the extent that the securities delivered to X are of the nonexempt class, such as cash or its equivalent.

Well now, another illustration under subparagraph (B) would arise where it was desired to eliminate minority owned subsidiary Y from the H holding company system. That is over on the left. The securities of Y owned by H under H's portfolio are to be sold or traded to anyone in exchange for any kind of property; that is, H is going to cut Y loose from this system.

Senator KING. It does it by paying tax or by giving him stock in a new corporation that might be organized?

Mr. DOUGLAS. Yes; they might exchange the stock that they held in Y for, say, a transmission line or a generating plant, or additional securities in one of these other subsidiary companies, since Y, for example, might be a company that could not practically be geographically integrated.

Senator CONNOLLY. In this set-up is Y an operating company?

Mr. DOUGLAS. Yes. Now, under the existing law both H and the other party to the trade would be taxable on the full amount of the gain which each realized at the time of the exchange. The fact that the stock which H disposes of is stock in its own subsidiary, is immaterial under the present tax law.

Under the proposed amendment, no gain or loss would be recognized with respect to H except to the extent of the nonexempt property received; that is, cash and its equivalent, short-term paper, and so on. The other party to the exchange would be treated the same as under existing law, unless he could qualify for nonrecognition in the same manner as H; that is to say, if the property or the securities of Y were being transferred to an outsider who is not under the umbrella of a Commission order under section 11, that person pays the usual tax; but if that transfer is pursuant to an order of the Commission whereby the transferee is under the umbrella of an order under section 11, then that transferee gets the same kind of exemption as the transferor does.

Senator KING. Mr. Douglas, do not you perceive complications that are almost inextricable in trying to assess taxes where these changes are taking place? How are you going to determine value? How are you going to determine losses or gains?

Mr. DOUGLAS. Well, you get that in any of these situations. First, the computation of what the basis for the old securities or property is; second, what the fair market value of the new ones is. That is a problem on which I have had no experience, because I am not a tax expert, and I do not purport to be.

Senator KING. That is a problem for the Treasury experts, or Treasury officials, the collecting agencies of the Treasury Department.

Mr. DOUGLAS. Yes; it is.

Now, another illustration under subparagraph (B) is where one of these subsidiaries, say K company, owns a transmission line and a distribution system which extends into the territory of some other system. Now, one of our typical problems there is to get these physical assets properly grouped in the light of the statutory standard. Now, one of the things that might be done there would be to have K exchange that transmission line and distribution system that lies outside of its territory for a generating station belonging to another company that lies inside its territory. That might be a swap. Now, under existing law, as I read it, only property held for productive use or for investment may be exchanged, tax free, for property of like kind; that is, a transmission line for a transmission line or a generating plant for generating plant, but not a transmission line for a generating plant. Hence, in the transaction stated, there might be a recognized gain to both parties. Under the proposed amendment no gain or loss will be recognized to either party if it is a registered holding company or an associate company, and the transfer is made pursuant to an order of the Commission under section 11.

Now, under subsection (C), we are dealing there with what might be called partial liquidations to shareholders. For example, W off there to the right is the company which, let us assume, may not properly be considered as a part of the integrated system H under section 11 (b), and its securities, that is the securities of W, owned by H are therefore distributed directly to the shareholders of H. So that W gets out of the system. It is just lopped off, sloughed off.

Now under existing law, as I read it, the fair market value of the securities received by the shareholders of H would be treated as a taxable dividend to the extent that they are attributable to earnings and profits accumulated since February 28, 1913, and, to that extent, would be subject to both normal tax and surtax, and any value in

excess of this amount would be treated as a return of capital and would reduce the basis of their stock in the H company.

Under the proposed amendment, no gain or loss would be recognized to the shareholders of H from the receipt of the securities distributed. If those shareholders subsequently sold, there would be brought into play the normal provisions of the law. But where we are requiring the company to distribute those securities, the incidence of the relevant tax is postponed until a transaction appears which is of a noncompulsory nature.

Senator CONNALLY. In that case it amounts literally to partial liquidation?

Mr. DOUGLAS. Yes; partial liquidation.

Now, to recapitulate, under existing law as a general rule the individual shareholder enjoys the nonrecognition privilege only if he exchanges common stock for common stock, or preferred stock for preferred stock, in the same company; or if he exchanges his securities in a reorganization, which term, by definition is, generally speaking, limited to a mere change of identity or form, a recapitalization, a statutory merger or consolidation, or a transaction wherein substantially all of the stockholders transfer their stock to a corporation in exchange for its stock and have an 80-percent control of such corporation after the transfer. Under the proposed amendments an individual stockholder can receive, tax free, securities, with certain exceptions, such as short-term securities which are almost the equivalent of cash, from any registered-holding company or majority-owned subsidiary by way of exchange or distribution, where it is under order of the commission.

Senator CONNALLY. When you say "tax free" you mean by reason of that transfer?

Mr. DOUGLAS. By reason of that transfer. He would pay a tax on any gain to the extent of the boot received and the property would acquire in his hands a substituted basis.

Senator TOWNSEND. The boot would have to be received in cash?

Mr. DOUGLAS. In cash, or what is defined in this proposed amendment as a nonexempt security, which includes cash, or what, for normal purposes, may be considered its equivalent.

Now under subsection (D) there is more liberal treatment accorded, under the proposed amendment, to transactions between members of a system group, that is companies within one holding company system, i. e., where the common parent owns, directly or indirectly, at least 90 percent of each class of stock, other than stock which is preferred as to both dividends and assets, of those companies. In other words, where you have a closely held group (closely held in the sense of one top company having 90 percent, directly or indirectly, of each class of stock of the underlying company, except the preferred stock which I have referred to) when we hit that situation, Mr. Chairman, and start moving properties around within that system under section 11 of our statute, it is something like taking them from the left-hand pocket and placing them in the right-hand pocket.

There was some discussion as to whether or not we ought to have as a standard test for a system group 100-percent ownership by a common parent. That would not be workable, because that situation does not always obtain. There may sometimes be a small interest outstanding in the hands of the public. So 90 percent was adopted,

90 percent was as far as we felt we could go downward, in order to minimize, insofar as practicable, the inequity which might be done to any minority interest by reason of the use of the transferred basis which is provided for in connection with system-group transactions.

Let me give you an illustration. If a 90-percent owned company bought from a similar company for $10,000,000 a plant with a basis for tax purposes in the hands of the seller of $8,000,000, which basis is transferred, that is, goes with the property, then the buying company would in the future be allowed to take depreciation on the basis of only $8,000,000 and not $10,000,000. Thus its earnings, after payment of taxes, would be smaller than if it had been permitted to depreciate on the basis of $10,000,000. Now that might be inequitable to some of the minority interests in that situation. As far as the system is concerned there is no difference, in my opinion, since the plant was depreciable on the $8,000,000 basis in the hands of the selling company. Whether it is in the right-hand pocket or the left-hand pocket, as far as the system is concerned, does not seem to make much difference. But the minority interest in the buying company is adversely affected.

Senator CONNALLY. The 10 percent might be penalized by transferring from one company to the other.

Mr. DOUGLAS. We thought it necessary to select a transferred basis for a transaction within a system-group, since we felt it desirable to grant nonrecognition of gain or loss, even in case where cash was the sole consideration, for the reason that it seemed to us that with these 90-percent-owned companies, cash moving around from one to the other was like putting it from one pocket into another pocket. If those transactions were necessary, in the view of the Commission toward effectuating the objectives of the Congress in the Public Utility Holding Company Act under section 11, then the mere fact that it might be in the form of cash should not bring down the burden of the tax as long as it was within a closely held system. I will give you a few illustrations of that paragraph (D), if you like, Mr. Chairman.

The CHAIRMAN. I think it would be very well, because I am going to ask to have placed in the Congressional Record your explanation of this, so that others who might be interested may read it.

Mr. DOUGLAS. Take S company; S company has properties which have a market value of $5,000,000, but a basis of $4,000,000 for income-tax purposes, and, in order to eliminate the S company, the R company pays the S company $5,000,000 for its properties. Now, under the existing law S company realizes a taxable profit of, I believe, $1,000,000, and R company acquires the properties at a basis of $5,000,000 in determining its depreciation or gain or loss upon a subsequent sale. Now, under the amendment no gain or loss is recognized to S company upon the sale, and R company is required to use the basis of $4,000,000 in computing depreciation and for future income-tax purposes. In other words, R takes the basis that S had, that is transferred to R, and there is no recognition of any capital gain to S.

Senator CONNALLY. Although the stockholders in S would have made $1,000,000?

Mr. DOUGLAS. I beg your pardon?

Senator CONNALLY. The stockholders in S company would have made $1,000,000?

Mr. DOUGLAS. That is just as respects that transfer. On payment of that money to the outside stockholders, these stockholders would be taxable.

Suppose that R buys the property of S and pays for it with its own newly issued senior securities. Under the present law S would be taxable on the gain measured by the difference between the basis which the property had in its hands and the fair market value of the securities received; after the transaction the property and the securities would each have a basis of $5,000,000. Under the amendments no gain would be recognized to S and after the transaction the property and the securities would each have a basis of $1,000,000.

Assume that R sells its interest in V to T for cash or for T's newly issued senior securities. Under existing law R may have a taxable gain; under the amendments no gain is recognized.

If R later sells all or part of the securities for cash, under existing law it would be taxable on the gain measured by the difference between its own old basis for its interest in V and the amount of cash received. Under the amendments no gain or loss will be recognized to R if it uses the proceeds from such sale to retire its own senior securities. Furthermore, if such proceeds are in excess of the amount used by R to retire senior securities, the recognized gain or loss to R will be limited to such excess; and if the amount received by R at the time of their sale is in excess of the fair market value of the securities at the time of their receipt, only the gain limited to the extent of such excess would be taxable.

Senator VANDENBERG. When you get through with the collapse, is the total amount of securities outstanding the same as it was in the first place?

Mr. DOUGLAS. The collapse—pardon me for using that word——

Senator VANDENBERG. You have got me using it now.

Mr. DOUGLAS. —would normally involve capital structure simplification as well as corporate simplification. That is under the standards of the statute the type of security which is normally available for the holding company (though not exclusively) is not debentures or what not, but common stock. Now, there are exceptions to that, but normally you get a more conservative capital structure under this statute. The statute envisages doing the job not only of a corporate simplification, but incident to that a recapitalization which takes the water out, and so on.

Senator KING. What becomes of the innocent purchasers who have been purchasing for years at high prices, who have small holdings, a few shares? They would be wiped out entirely, would they not?

Mr. DOUGLAS. Well, if there is no value there——

Senator VANDENBERG (interrupting). They collapse.

Senator KING. But they paid cash for their stuff.

Mr. DOUGLAS. We are not setting up, under this statute, any system for the underwriting of losses that investors have suffered in these systems. The operation of the statute is designed to preserve the real value there, taking out the water and reducing these companies to a conservative basis. Some people are going to realize finally that they have a piece of paper rather than something of real value.

Senator CONNALLY. Your job is to justify values as you find them.

Mr. DOUGLAS. Yes. Our job is to see to it that the values that are there are preserved for the benefit of the security holders. We cannot manufacture values any more than any other group can manufacture values.

Senator TOWNSEND. Have you any basis on which you fix values?

Mr. DOUGLAS. The Congress has given us, under the statute, various types of criteria to apply. For example, in the issuance of securities under section 7 the standards are quite explicit, e. g., "Is this security reasonably adapted to the earning power of the company?" They are all in the statute, and we try to apply those.

The CHAIRMAN. Congress laid down the measuring stick and that is what you have got to follow.

Mr. DOUGLAS. That is all we are trying to do, to follow those criteria. The question of values is not an easy one, as you know.

Senator VANDENBERG. And is one of the purposes the purpose to bring the total stock outstanding down to a parallel with the values that are apparent?

Mr. DOUGLAS. Yes; to get rid of these tiers upon tiers of companies and the crazy pyramiding, where the fellow who paid $100 in the top company for a share of stock could not, with all of the mathematicians available, figure out what value he had. There is no way of telling.

Senator VANDENBERG. Suppose he has a loss as the result of this compulsory reorganization, can he deduct that loss under this amendment?

Mr. DOUGLAS. There is no recognition of gain or loss. If he is forced to take a security in exchange for the security that he has, that is true.

Senator CONNALLY. Mr. Douglas, right there, by reason of the forced transfer that might be so, but if his stock was worthless when he transferred he could get credit for that, could he not?

Mr. DOUGLAS. Take the case that we have not finally disposed of yet. We had a case where there were, I think, four or five holding companies on top of an operating company. Anyway you wanted to figure it there was nothing left for the security holders of three of those companies, unless you just wanted to do what the holding company promoters did and start manufacturing value.

Senator GEORGE. In all cases you would give the paper back?

Mr. DOUGLAS. In those cases, those people that held securities in those top three companies would not get anything.

Senator GEORGE. Not even the paper?

Mr. DOUGLAS. There would not be anything to distribute to them, therefore there would not be, as respects them, any transfers of any securities pursuant to an order of the Commission. In other words, they would not come under the umbrella because they are just sloughed off, there is nothing to pass up to them. The other provisions of the statute would be applicable to them, but not the proposed amendment.

Senator BARKLEY. In any case where the operating property, which formed the basis of all the pyramided structure above it, were of sufficient value to have justified the issuing of this stock in one tier or another, there would be no actual loss to those who held stock in the holding company?

Mr. DOUGLAS. That is right.

Senator BARKLEY. That may be a very rare situation. It is possible in some cases that it does exist. Therefore, there would be no loss by this consolidation and elimination.

Mr. DOUGLAS. Oh, yes; you have got good holding company systems as well as bad holding company systems. I mean you have got all shades of corporations all the way through.

Senator CONNALLY. The point I am trying to arrive at is your amendment only applies to the gain or loss that might occur by reason of the enforced transfer?

Mr. DOUGLAS. Yes.

Senator CONNALLY. If a man had already suffered a loss in his stock, if he paid $100 for the stock, and after the transfer it was worth $10, he could take the $90 loss under the other general provisions of the statute, could he not?

Mr. DOUGLAS. That is true if he later sold what he received for $10.

Senator CONNALLY. Whatever the applicable statute is.

Mr. DOUGLAS. That is true.

Senator CONNALLY. Your proposition is that by reason of the enforced transfer it is the value as of the date of the transfer and no loss or no profit should be taken, is that it?

Mr. DOUGLAS. That is correct; no gain or loss would be recognized at that point.

The CHAIRMAN. Mr. Douglas, I wanted to ask you this question: There have been some of these holding companies that have already liquidated voluntarily, does this amendment apply to them the same as to the future?

Mr. DOUGLAS. Yes; it would, because those companies—I think of one or two—where the actual transfers have not as yet been made. The transfers are dependent upon the ability of the company to get some financing, and under the present condition of the capital market it is not practicable to do very much financing. So while they have got their paper plans laid out and while the Commission has said, "O. K., those plans are all right, you can go ahead and do it," they have got to sell some securities to raise some cash. Therefore, they are just marking time. So an order comes along, and there will be supplementary orders and those supplementary orders would protect them.

The CHAIRMAN. So the same rule would apply under this section of this compulsory liquidation, the same rule would apply to those who have already liquidated as to those that might liquidate in the future?

Mr. DOUGLAS. It was the intention to do that.

Senator VANDENBERG. Well, the protection of this individual stockholder that Senator Connally is talking about would finally depend upon the interpretation of the Treasury Department as to whether there was any connection between the disclosure and the order which you had issued.

Mr. DOUGLAS. Yes.

Senator VANDENBERG. The stockholder would finally be at the mercy of the Treasury's interpretation.

Mr. DOUGLAS. Under that hypothetical case, the case where we just said there was nothing for the top three holding companies, no value at all for them, those securityholders would not be under the umbrella of our order, because they would not be getting anything. Therefore they would fall under the other provisions of the statute, and

whether the other provisions of the statute would permit them to take a loss is something I ought not to testify on, because I am not a tax expert.

Senator VANDENBERG. It permits them to take a loss provided they make a gain, otherwise it does not.

Senator BULKLEY. Does this exempt corporations that have already dissolved under compulsion?

Mr. DOUGLAS. As I told the chairman, it is designed to do that.

Senator BULKLEY. It is designed to do that?

Mr. DOUGLAS. Yes. We have just started on that. While we entered a couple of orders, the process is just getting under way.

Senator BULKLEY. You mean nobody has dissolved yet?

Mr. DOUGLAS. There may have been some actual dissolutions; I do not want to say that there have not been.

Senator BULKLEY. Anyway, you intend this to exempt them?

Mr. DOUGLAS. To the extent——

Senator BULKLEY (interrupting). Well, to the same extent as the others?

Mr. DOUGLAS. That is right. This is not designed to go back and reopen completed transactions; it is not designed to do that.

Senator BULKLEY. There would be no occasion to do that, because there are no completed transactions under compulsion; is that right?

Mr. DOUGLAS. Well, things move pretty fast from day to day. I do not want to say, Senator, that there are not. There may be. I do not think there are any of any significant consequence.

Senator KING. It is not retroactive to completed transactions, but it deals in future?

Mr. DOUGLAS. That is right. I think, Mr. Chairman, that that covers the high spots.

Senator LA FOLLETTE. If you have finished with (D), Mr. Douglas, I would like to ask you whether you anticipate that once the provisions of this amendment are publicly known whether there will be any effort made to lower this 90-percent percentage under (D) and whether you have said or you care to say as to the reasons that you arrived at 90 percent, and any reasons you have, if you have any, as to why it should not be reduced below 90 percent?

Mr. DOUGLAS. I do not know, Senator La Follette, the extent to which there might be a drive to get that percentage lowered.

Senator LA FOLLETTE. Well, they get more favorable treatment, do they not?

Mr. DOUGLAS. They do.

Senator LA FOLLETTE. As long as there is any historic experience, as long as there is any more favored treatment to be had, whenever you draw a line the people that do not come within it are always anxious to get the line moved over so it will include them. I would like to know if you have given us all the reasons that you have for having fixed it at 90-percent ownership, under section (D).

Mr. DOUGLAS. I have tried to, Senator La Follette. The reasons are to permit certain types of conservative transactions in a pure holding company system group. It would be our desire, if practicable, to put that at 100 percent, but if you put it at 100 percent you are, as a practical matter, not going to include a number of situations, where the control is just a little short of 100 percent. You will, in our judgment, accomplish conservatively the objectives of

permitting some prompt action; some elbow room in moving around within these systems, if it is kept at 90 percent.

Now that is purely an arbitrary figure; there is no question about it. I would be here opposing any reduction of that very vigorously, because if you start moving it down then you are opening it up to a large number of cases that, in my opinion, would give rise to abuses to minorities in these systems. But I think that the possible injury to minorities would be minimized if it is kept at that figure of 90 percent, and at the same time you will permit a little elbow room. There is no particular magic in the formula of 90 percent that was worked out. That is purely arbitrary; it is designed merely to give a little flexibility. I would like to go on record as saying I would not like to see it reduced.

The CHAIRMAN. Is there something else now?

Mr. DOUGLAS. I think that covers it all, Mr. Chairman.

(The amendment referred to by Mr. Douglas is as follows:)

On page 95, after line 25, insert the following:

"(7) EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION.—

"(A) No gain or loss shall be recognized to the transferor if stock or securities in a corporation which is a registered holding company or a majority-owned subsidiary company are transferred to such corporation or to an associate company thereof which is a registered holding company or a majority-owned subsidiary company solely in exchange for stock or securities (other than stock or securities which are nonexempt property), and the exchange is made by the transferee corporation in obedience to an order of the Securities and Exchange Commission.

"(B) no gain or loss shall be recognized to a transferor corporation which is a registered holding company or an associate company of a registered holding company, if such corporation, in obedience to an order of the Securities and Exchange Commission transfers property solely in exchange for property (other than nonexempt property), and such order recites that such exchange by the transferor corporation is necessary or appropriate to the integration or simplification of the holding company system of which the transferor corporation is a member.

"(C) If there is distributed, in obedience to an order of the Securities and Exchange Commission, to a shareholder in a corporation which is a registered holding company or a majority-owned subsidiary company, stock or securities (other than stock or securities which are nonexempt property), without the surrender by such shareholder of stock or securities in such corporation, no gain to the distributee from the receipt of the stock or securities so distributed shall be recognized.

"(D) No gain or loss shall be recognized to a corporation which is a member of a system group (i) if such corporation, in obedience to an order of the Securities and Exchange Commission, transfers property to another corporation which is a member of the same system group in exchange for other property or money or (ii) if there is distributed, in obedience to an order of the Securities and Exchange Commission, to such corporation as a shareholder in a corporation which is a member of the same system group, property or money, without the surrender by such shareholder of stock or securities in the corporation making the distribution. If an exchange or distribution with respect to which no gain or loss is recognized under the provisions of this subparagraph may also be considered to be within the provisions of subparagraph (A), (B), or (C), then the provisions of this subparagraph shall apply to the recipient corporation which is a member of the system group involved in such exchange or distribution. If the property received upon an exchange which is within the provisions of this subparagraph consists in whole or in part of stock or securities issued by the corporation from which such property was received, and if in obedience to an order of the Securities and Exchange Commission such stock or securities (other than stock which is not preferred

as to both dividends and assets) are sold and the proceeds derived therefrom are applied in whole or in part in the retirement or cancellation of stock or of securities of the recipient corporation outstanding at the time of such exchange, no gain or loss shall be recognized to the recipient corporation upon the sale of the stock or securities with respect to which such order was made; except that if any part of the proceeds derived from the sale of such stock or securities is not so applied, or if the amount of such proceeds is in excess of the fair market value of such stock or securities at the time of such exchange, the gain, if any, shall be recognized, but in an amount not in excess of the proceeds which are not so applied, or in an amount not more than the amount by which the proceeds derived from such sale exceed such fair market value, whichever is the greater.

"(E) (i) If an exchange (not within the provisions of subparagraph (D)) would be within the provisions of subparagraph (A) or (B) if it were not for the fact that property received in exchange consists not only of property permitted by such subparagraph to be received without the recognition of gain or loss, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property, and the loss, if any, to the recipient shall not be recognized.

"(ii) If an exchange is within the provisions of clause (i) of this subparagraph and if it includes a distribution which has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under such clause (i) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under such clause (i) shall be taxed as a gain from the exchange of property.

"(F) As used in this paragraph and in section 113 (a) (17)—

"(i) The term 'order of the Securities and Exchange Commission' means an order issued prior to January 1, 1940, by the Securities and Exchange Commission to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935 (including any order issued by the Commission subsequent to December 31, 1939, in which it is expressly stated that an order issued prior to such date is amended or supplemented) and which has become final in accordance with law.

"(ii) The terms 'registered holding company', 'holding-company system', and 'associate company' shall have the meanings assigned to them by section 2 of the Public Utility Holding Company Act of 1935.

"(iii) The term 'majority-owned subsidiary company' of a registered holding company means a corporation, the stock of which representing in the aggregate more than 50 per centum of the total combined voting power of all classes of stock of such corporation entitled to vote (not including stock which is entitled to vote only upon default or nonpayment of dividends or other special circumstances) is owned wholly by such registered holding company, or partly by such registered holding company and partly by one or more majority-owned subsidiary companies thereof, or by one or more majority-owned subsidiary companies of such registered holding company.

"(iv) The term 'system group' means one or more chains of corporations connected through stock ownership with a common parent corporation if—

"(1) At least 90 per centum of each class of the stock (other than stock which is preferred as to both dividends and assets) of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

"(2) The common parent corporation owns directly at least 90 per centum of each class of the stock (other than stock which is preferred as to both dividends and assets) of at least one of the other corporations; and

"(3) Each of the corporations is either a registered holding company or a majority-owned subsidiary company.

"(v) The term 'nonexempt property' means—

"(1) Any consideration in the form of a cancellation or assumption of debts or other liabilities (including a continuance of encumbrances subject to which the property was transferred);

"(2) Short-term obligations (including notes, drafts, bills of exchange, and bankers' acceptances) having a maturity at the time of issuance of not exceeding twenty-four months, exclusive of days of grace;

"(3) Securities issued or guaranteed as to principal or interest by a government or subdivision thereof (including those issued by a corporation which is an instrumentality of a government or subdivision thereof);

"(4) Securities which were acquired after February 28, 1938, unless such securities (other than obligations described as nonexempt property in clause (2) or (3)) were acquired in obedience to an order of the Securities and Exchange Commission;

"(5) Money, and the right to receive money not evidenced by a security other than an obligation described as nonexempt property in clause (2) or (3); and

"(vi) The term 'stock or securities' means shares of stock in any corporation, certificates of stock or interest in any corporation, notes, bonds, debentures, and evidences of indebtedness (including any evidence of an interest in or right to subscribe to or purchase any of the foregoing).

"(G) The provisions of this paragraph shall not apply to an exchange or distribution unless (i) the order of the Securities and Exchange Commission in obedience to which such exchange or distribution was made recites that such exchange or distribution is necessary or appropriate to effectuate the provisions of section 11 (b) of the Public Utility Holding Company Act of 1935, (ii) such order specifies and itemizes the stock and securities and other property which is ordered to be transferred and received upon such exchange or distribution, and (iii) such exchange or distribution was made in obedience to such order and was completed within the time prescribed therefor in such order.

"(H) If an exchange or distribution made in obedience to an order of the Securities and Exchange Commission is within the provisions of this paragraph and may also be considered to be within the provisions of any other paragraph of this section, then the provisions of this paragraph shall apply."

On page 103, line 2, after "(15)" insert "or (17)".

On page 109, between lines 16 and 17, insert the following:

"(17) PROPERTY RECEIVED IN OBEDIENCE TO CERTAIN ORDERS OF SECURITIES AND EXCHANGE COMMISSION.—

"(A) If the property was acquired upon an exchange described in section 112 (b) (7) (A), (B), or (E), the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part of the type of property permitted by section 112 (b) (7) (A) or (B) to be received without the recognition of gain or loss, and in part of nonexempt property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such nonexempt property (other than money) an amount equivalent to its fair market value at the date of the exchange. This subparagraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it.

"(B) If, in connection with a transfer described in section 112 (b) (7) (A), (B), or (E), the property was acquired by a corporation, either as paid-in surplus or as a contribution to capital, or in consideration for stock or securities issued by the corporation receiving the property (including cases where part of the consideration for the transfer of such property to the corporation consisted of property or money in addition to such stock or securities), then the basis shall

be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

"(C) If the stock or securities were received in a distribution subject to the provisions of section 112 (b) (7) (C), then the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed.

"(D) If the property was acquired by a corporation which is a member of a system group, and if gain or loss to such corporation from the receipt of such property was not recognized by virtue of the provisions of section 112 (b) (7) (D), then the basis shall be the same as it would be in the hands of the transferor; except that if such property is stock or securities issued by the corporation from which such stock or securities were received and they were issued (i) as the sole consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either (1) the same as in the case of the property transferred therefor, or (2) the fair market value of such stock or securities at the time of their receipt, whichever is the lower; or (ii) as part consideration for the property transferred to such corporation, then the basis of such stock or securities shall be either (1) an amount which bears the same ratio to the basis of the property transferred as the fair market value of such stock or securities at the time of their receipt bears to the total fair market value of the entire consideration received, or (2) the fair market value of such stock or securities at the time of their receipt, whichever is the lower."

On page 117, line 21, beginning with "In," strike out through the period in line 3, page 118, and insert in lieu thereof the following:
"In the case of amounts distributed (whether before January 1, 1938, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits."

On page 120, line 25, beginning with "The," strike out through line 6, page 121, and insert in lieu thereof the following:
"The distribution (whether before January 1, 1938, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

"(1) if no gain to such distributee from the receipt of such stock or securities, property, or money, was recognized by law, or."

On page 135, line 15, before the comma insert a comma and the words "or under the provisions of section 112 (b) (7) (C) of this Act."

STATEMENT OF HON. JOSH LEE, UNITED STATES SENATOR FROM THE STATE OF OKLAHOMA

Senator LEE. Mr. Chairman, it is my purpose to prove the following contentions:

First, that this administration is committed to the policy of protecting dry States from the importation of liquor.

Second, that the dry States are not receiving Federal protection from the importation of liquor; and

Third, that the amendment which I propose will afford protection for the dry States from the importation of liquor.

PLEDGE TO PROTECT DRY STATES

As to the first contention, I wish to quote from the Democratic platform of 1932. After the paragraph which declared for the

repeal of the eighteenth amendment, the Democratic Party, in order to give assurance to dry States that they would be protected, pledged itself in its platform as follows:

We demand that the Federal Government effectively exercise its power to enable the States to protect themselves against importation of intoxicating liquors in violation of their laws.

Then, again, I wish to quote the words of the Democratic candidate, Franklin D. Roosevelt, in his acceptance speech at the Chicago convention in 1932:

I say to you now that from this date on the eighteenth amendment is doomed. When that happens we, as Democrats must and will, rightly and morally, enable the States to protect themselves against the importation of intoxicating liquor where such importations may violate their State laws.

Then followed the adoption of the twenty-first amendment by the Congress of the United States first and by the State conventions afterward. The first paragraph of the twenty-first amendment repealed the eighteenth amendment. The second paragraph guaranteed protection to the dry States in the following language:

The transportation or importation into any State, Territory, or possession of the United States, for delivery or use therein, of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

Then on December 5, 1933, President Roosevelt, in proclaiming the date of repeal of the eighteenth amendment, in order to further emphasize the guarantee of protection for the dry States, made this significant statement:

I call specific attention to the authority given by the twenty-first amendment to the Government to prohibit transportation or importation of intoxicating liquors into any State in violation of the law of such State.

There was no doubt in the minds of the average citizens of the United States that it was the intent and purpose of the Federal Government to protect dry States from the importation of liquor. Ministers of the gospel who were opposed to repeal itself quoted the President's words with the full belief that the States could still remain dry and have the protection of the Federal Government. Members of the Democratic Party in their campaign speeches assured the people of dry States that they would have Federal protection from the importation of liquor. In fact, the question was never raised nor was it ever doubted even by the opponents of repeal that the Federal Government would give Federal protection to the dry States.

The language of the twenty-first amendment was so plain that there was no room for doubt. It says, in pure, unadulterated English:

The transportation or importation into any State, Territory, or possession of the United States, for delivery or use therein, of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

It is so plain that "the wayfaring man though a fool need not err therein." It is so plain that "He who runs may read."

This administration is unequivocally pledged to protect the dry States from the importation of liquor.

HISTORY OF FEDERAL LIQUOR LAWS

Now what is the history? On March 3, 1917, Congress passed an act that protected the dry States from the importation of liquor in the following language:

> Whoever shall order, purchase, or cause intoxicating liquors to be transported in interstate commerce, except for scientific, sacramental, medicinal, and mechanical purposes, into any State or Territory, the laws of which State or Territory prohibit the manufacture or sale therein of intoxicating liquor for beverage purposes, shall be punished as aforesaid: *Provided*, That nothing herein shall authorize the shipment of liquor into any State contrary to the laws of such State.

The punishment prescribed by law for violation of the above statute was a fine of not more than $1,000 or imprisonment of not more than 6 months, or both, and for any subsequent offense, imprisonment for not more than 1 year.

This statute was amended January 11, 1934, by the law known as the Liquor Taxing Act of 1934, the only change being that the District of Columbia was included.

The Federal officers were successful in enforcing this law. Here I wish to quote in part from Mr. Charles N. Champion, assistant district attorney of the eastern district of Oklahoma. He writes:

> The Federal officers of this district have been diligent in enforcing the above statute and, as I recall, in no instance was there an acquittal. No question was ever raised by the Federal Government as to whether the above statute was enforcible or applicable in Oklahoma, and, frankly, I am of the opinion that had the question been raised the courts would have held that the statute was applicable and enforcible in this State.

Now, that is the law of 1934. Then the punishment was a thousand-dollar fine, or 6 months in jail, or both.

Senator KING. That statute seemed to afford ample protection for the States?

Senator LEE. It did until repealed by the Treasury Department.

The CHAIRMAN. Senator, did you offer an amendment that went to the Judiciary Committee on this proposition?

Senator LEE. Yes; I offered an amendment to the act of 1936.

The CHAIRMAN. Was it somewhat similar to this?

Senator LEE. Somewhat similar to this; yes. I think it is some improvement.

The CHAIRMAN. What is the status of that amendment that went to the Judiciary Committee?

Senator LEE. Senator King can answer that.

Senator KING. It was sent to a subcommittee of which I am chairman, and I intended to call the committee together to take charge of it just as soon as we get the chance.

The CHAIRMAN. As I understand your contention, the law is not being enforced in Oklahoma; is that right?

Senator LEE. That is right; but let me say, according to the Treasury Department, it is not applicable, and that is the reason. I would like to go on with this. I have it in sequence. I believe it will unfold itself.

Senator TOWNSEND. Is Oklahoma the only State to which it is not applicable?

Senator LEE. No; there are three dry States, I guess there are four—Kansas, Mississippi, and Tennessee.

Senator TOWNSEND. And Oklahoma.

Senator LEE. I am not familiar with the other States, but that is what I understand.

The district attorney of the eastern district of Oklahoma pointed out that under the law of 1934 in no instance, as he remembered, had there been an acquittal under that law, and they were prosecuting and getting convictions. He says:

No question was ever raised by the Federal Government as to whether the above statute was enforcible or applicable in Oklahoma; and, frankly, I am of the opinion that had the question been raised the courts would have held that the statute was applicable and enforcible in this State.

Then, on August 27, 1935, Congress passed an act known and designated as the Liquor Law Repeal and Enforcement Act. It reads as follows:

The shipment or transportation, in any manner or by any means whatsoever, of any spirituous, vinous, malted, fermented, or other intoxicating liquor of any kind, from one State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, which said spirituous, vinous, malted, fermented, or other intoxicating liquor is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either in the original package or otherwise, in violation of any law of such State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, is hereby prohibited.

The above-quoted act was formerly known as the Webb-Kenyon law which was retained in force by the 1935 act. It, however, has no penal provision, and therefore, no criminal prosecution could be based thereon.

Then in 1936, Congress passed the Liquor Enforcement Act of 1936, which was approved June 25, and became effective 30 days later.

Senator KING. Is that the one under which you claim no enforcement is possible?

Senator LEE. That is right. This act was passed to make the twenty-first amendment effective. It was the law that followed the adoption of the twenty-first amendment. It was intended to provide a penalty in order to make the twenty-first amendment effective. The Members of Congress, both the House and Senate, evidently had in mind when voting for the passage of the Liquor Enforcement Act of 1936, that they were thereby vitalizing the twenty-first amendment.

There was the feeling when this law was passed that the party pledge of protection to the dry States had been fulfilled, because the language of the twenty-first amendment says that the importation of liquor into States in violation of State laws is prohibited, and the Liquor Act of 1936 was to vitalize this part of the amendment.

The particular section of the Liquor Act of 1936 that was to make effective this guaranty of protection is found in section 3, which provides as follows, and I hope you will follow this, because this is the point at issue:

(a) Whoever shall import, bring, or transport any intoxicating liquor into any State in which all sales (except for scientific, sacramental, medicinal, or mechanical purposes) of intoxicating liquor containing more than 4 per centum of alcohol by volume are prohibited, otherwise than in the course of continuous interstate transportation through such State, or attempt so to do, or assist in so doing, shall: (1) If such liquor is not accompanied by such permit or permits, license or licenses, therefor as are now or hereafter required by the laws of such State; or (2) if all importation, bringing, or transportation of intoxicating liquor into such State is prohibited by the laws thereof; be guilty of a misdemeanor and shall be fined not more than $1,000, or imprisoned not more than one year, or both.

The Treasury Department to whom we look for the enforcement of this law was largely responsible for the language of this provision. Representatives of the Treasury Department sat in the counsels and helped draft this provision, according to Mr. Stewart Berkshire, Deputy Commissioner of Internal Revenue. I believe he is here this morning, and I am sure he will say the same thing.

There was certainly no feeling on the part of the Members of Congress that they had in the passage of this act, repealed the liquor-taxing law of 1934, and removed the Federal protection from the States. There was, on the contrary, the satisfied feeling that they had discharged their duty in accordance with the party pledge and the twenty-first amendment. The laymen were certainly under the impression that the dry States were given full Federal protection by the passage of this law, because the law violators themselves who are usually the first to find a loophole, never thought of attacking the law, never once raised the question of the applicability of the law. Had liquor racketeers presumed for a moment that this law would not protect the dry States, they would immediately have started a caravan of liquor into the dry States, but this did not happen because they were under the impression, as were most people, that the passage of the Liquor Enforcement Act of 1936 strengthened the protection of the States rather than destroyed it.

Officers of the law continued to make arrests and prosecutions for the importation of liquor into dry States, except the Federal agents who operate under direction of the Treasury Department.

Here I wish to quote another paragraph from Mr. Champion's letter. Bear in mind that he is assistant district attorney of the Eastern District of Oklahoma. I quote:

> After the passage and approval of the above act (the Liquor Enforcement Act of 1936) this office continued with the prosecution of cases in this district against persons for introducing and transporting tax-paid whisky from either Arkansas or Texas into Oklahoma. Arrests have been made altogether in such cases by the United States marshal and his deputies. After the passage of the Liquor Enforcement Act of 1936, above quoted, investigators of the Alcohol Tax Unit refused to adopt the cases.

May I again call your attention to the fact that the United States marshals and United States district attorneys continued to make arrests and to prosecute after the passage of the Liquor Enforcement Act of 1936, but that the investigators of the Alcohol Tax Unit serving under the Treasury Department refused to adopt the cases. I ask you to bear this in mind because the straws show the way the wind is blowing.

Senator KING. However, the district attorneys could have gone ahead regardless of the attitude of the Treasury Department?

Senator LEE. They did, as he just said in his letter.

Then I have another letter from the United States marshal of another district, which I will quote later.

Now, I wish to show that not only did the Federal officers of dry States believe that the Liquor Enforcement Act of 1936 was intended to protect dry States from the importation of liquor but that officers of wet States believed that the law gave dry States protection and offered their help to the Federal Government to effect that protection.

Mr. J. R. Ramsey, Texas supervisor, Tax Liquor Control Board, on August 7, 1936, just a little bit over a month after the Liquor Enforcement Act had been approved, wrote a letter to Mr. G. H.

Mooreman, Federal investigator, Alcohol Tax Unit, Wichita Falls, Tex., in which he pointed out that he had evidence indicating that liquor was being shipped from Texas into Oklahoma and offered his full cooperation in prohibiting such importations.

Then a week later Mr. J. C. Palmer, district supervisor of Louisiana, Mississippi, and Texas, Internal Revenue Service, under the Treasury Department, wrote to the deputy commissioner in Washington, D. C., and called his attention to the suspected importation of liquor from Texas into dry States. The district supervisor wrote, in part, as follows:

> It appears that the Texas Liquor Control Board is desirous of cooperation with this Bureau and such other governmental agencies as may have jurisdiction to investigate violations of this character. It appears that under act of Congress, June 25, 1936, effective the thirtieth day following its enactment (Public, No. 807, 74th Cong., H. R. 8368), section 5 places violations of this character under the jurisdiction of this Department. * * *

Now, that is the district supervisor. It is quite evident that Mr. Palmer, acting district supervisor of the Internal Revenue Service for three States, also believed that the Liquor Enforcement Act of 1936 "places violations of this character under the jurisdiction of this Department," the Treasury Department.

Now, the Members of Congress who voted for the Liquor Enforcement Act of 1936 believed that it gave Federal protection to the dry States. The liquor racketeers evidently believed that the law was in effect and gave protection to dry States. The district attorneys of the dry States and the United States marshals evidently believed that the law was effective in the protection of dry States. The Liquor Control Board officers of wet States believed that the law was in force in the protection of dry States, and even members of the internal-revenue organization evidently believed that Congress had some purpose in passing the Liquor Enforcement Act of 1936.

But surprise of surprises, out of a clear sky, the General Counsel of the Treasury Department announced on the 27th day of February 1937 that the Liquor Enforcement Act of 1936 did not protect dry States from the importation of liquor. Seven months after the law had been effective, the Treasury Department strikes it down.

This decision on the part of the Treasury Department was not the result of a lawsuit, but it was on the initiative of the Treasury Department itself.

The CHAIRMAN. Did they contend that the Department of Justice had jurisdiction and not the Treasury Department?

Senator LEE. I never saw such contention. That was not the basis on which they struck it down.

This opinion was rendered in a memorandum for Mr. Harold N. Graves, assistant to the Secretary of the Treasury, and was signed by Mr. Herman Oliphant, General Counsel for the Treasury Department, and sets forth this sentence in the last paragraph:

> The laws of Oklahoma have not provided for a permit system; therefore, that State may not receive Federal protection under the Liquor Enforcement Act of 1936.

It must be recalled that the State of Oklahoma was born dry. It is the one State that has prohibition written in the State constitution. When Oklahoma became a State in 1907 it came into the Union with prohibition written in its constitution, the supreme law of the State. Since that time it has, of course, passed statutes

making effective this constitutional prohibition. The laws of Oklahoma, as do the laws of other dry States, exempt the sale of alcohol for certain purposes, namely, scientific, sacramental, and medicinal purposes.

The liquor laws of Oklahoma have been in effect, therefore, since statehood, and have been operating with as much satisfaction as laws of that nature usually operate, and the twenty-first amendment specifically provides that the importation of liquor into States in violation of the laws of those States is prohibited.

Senator KING. Was not that statement of Mr. Oliphant really an invitation for the States to supplement their laws by providing for the permit, so that if they did then the dry States would be protected? The sentence which you read indicated, or it was an intimation, that because they had no permit system therefore the law was not applicable.

Senator LEE. May I read this paragraph? I think it will answer the permit argument.

Senator KING. All right.

Senator LEE. Sections 2596 and 2601, Oklahoma Statutes, 1931, make provision for alcohol for scientific institutions, universities, and colleges, hospitals, and bonded apothecaries, druggists, and pharmacists. Under the provisions of section 2596, supra, the Governor is authorized and empowered to prescribe rules and regulations in accordance with the constitution and laws of the United States for the sale of alcohol for these excepted purposes and in accordance with this provision of the statutes of Oklahoma Governor Murray promulgated such rules and regulations as the law required.

Now, evidently, the State of Oklahoma instituted a permit system that measures up to the desires of the Treasury Department, but Mr. Oliphant, General Counsel for the Treasury Department, states that the laws of Oklahoma have not provided for a permit system, therefore that State may not receive Federal protection under the Liquor Enforcement Act of 1936.

In this regard the question might be raised in your mind: Is Oklahoma an exception? Does the law protect the other dry States? To answer that question it is only necessary to read a paragraph from the circular sent out from the Treasury Department under date of April 16 to the district supervisors, quoting:

> It is understood that there are now no States, to which this act applies, that have permit or license systems covering importations of liquor.

Therefore, it is evident that Oklahoma is not an exception, but all of the dry States have fallen short of Mr. Oliphant's requirements in order to enjoy Federal protection.

Now, in fairness to the General Counsel, it should be stated that there is one other provision in the Liquor Enforcement Act of 1936 which would entitle dry States to Federal protection; that is, if the States prohibited all importation of liquor without exception for any purpose whatever, then they could enjoy Federal protection from the importation of liquor. According to the opinion of Mr. Oliphant, only where the States measure up in one of these two provisions can they enjoy Federal protection—that is, prohibit all liquor without any exception or else have a permit system that meets his requirements—and no single State in the Union met those requirements. According to the decision rendered by the General Counsel of the Treasury De-

partment, that makes the law null and void, since there is not a single State in the Union that prohibits all importation of liquor without a single exception, and since, according to the memorandum sent out from the Treasury Department—

It is understood that there are now no States to which this act applies that have permit or license systems covering importations of liquor.

Therefore, section 3 of the Liquor Enforcement Act of 1936 has no purpose, since it does not apply to a single State in the Union. The Members of Congress who passed it were simply voting for three paragraphs of idle words.

When Congress passes a law, it is presumed that the different departments of government will support that law. It is presumed that the law will have the full backing of all departments of the Government. Now, what happened in the case of the Liquor Enforcement Act of 1936, which was passed for the purpose of carrying out the twenty-first amendment? Was it attacked by enemies of the Government? No. Was it challenged by those who wished to profit by the importation of liquor into dry States? No; it was not challenged. Was it tested in a hard-fought lawsuit with the liquor interests on one side and the Government stoutly defending the law on the other? No; it was not tested in a lawsuit. It was beaten down by the Treasury Department, an arm of the Government that should have been its champion.

On February 27, 1937, out of a clear sky, the General Counsel of the Treasury Department, on its own initiative announced to the world that the Liquor Enforcement Act of 1936 did not protect the dry States from the importation of liquor. So far as I know, that is unprecedented. Has any court ever decided this case in accordance with the decision of the Treasury Department? No.

I wish to quote again Assistant District Attorney Champion, who writes as follows:

When this opinion was called to my attention, I did not agree with the ruling of the General Counsel of the Treasury Department, and consequently I continued to prosecute persons in this district for introducing and transporting whisky from Arkansas and Texas into Oklahoma. The question had not been raised and presented to the court as to whether or not this statute was applicable and enforceable in Oklahoma, and, naturally, I took the position that the law was enforceable until the Federal courts had held to the contrary.

Now, may I quote from a letter written November 22, 1937, by John P. Logan, United States marshal of the northern District of Oklahoma, 8 months after this law had been passed, 8 months after it had been announced null and void, in which he says:

DEAR SENATOR: I notice by the press that you are going to take some action with regard to the importation of intoxicating liquors into Oklahoma. I am very glad, indeed, that you are taking this in hand, and I want to give you briefly the situation as it is here, so that you may be fully advised regarding the matter.

On January 11, 1934, Congress passed an act prohibiting the importation of all intoxicating liquors into dry territory. Under this act I personally, with my men, proceeded to catch those bringing in whisky from the outside territory, and have now almost a room full of tax-paid whisky which was being imported into the States in violation of this act, and which we captured from those importing.

You understand that the Treasury Department issues revenue licenses to sell intoxicating liquors in the State of Oklahoma, and there was, up to July 1 of this year, 339 licensed whisky dealers in my district, with the total number of 176 in the city of Tulsa. It is to supply these dealers that the whisky is imported from Arkansas and Missouri.

The CHAIRMAN. I may say, Senator, in a letter from the general counsel of the Industrial Alcohol Institute, which was written March 25, they said they have examined this amendment, and they respectfully suggested that the amendment would not be germane to the pending revenue bill and should not be attached as a rider thereto. It is stated that the purposes and object of any amendment to such act should be left for consideration of the Committee on the Judiciary.

Senator King is chairman of that subcommittee. I am wondering if he can give any assurance to the committee that they are going to take the matter up?

Senator KING. As soon as you are going to take the tax bill out of here it will be the first thing that the committee will consider.

Senator LEE. Of course, Senator, when persons or departments are against something they use every means of sabotage to prevent its passage. In good faith I would not offer this if I did not feel it was, in principle and spirit, germane to a revenue bill, to be enforced by the Revenue Department. The liquor business has always been turned over to them. They were the ones that struck it down, and therefore you can see that it is simply a means to further delay this.

This will mean immediate protection. If our State legislature were in session I would appeal to them to correct the Treasury Department, but they will not be in session for a year. In the meantime the liquor is flooding our State and the Treasury Department is doing everything to sabotage and hinder this, because they will not enforce it.

The CHAIRMAN. I think the Treasury Department will want to be heard on it. I may say to you that I received a resolution passed by the Southern Baptist Convention, endorsing this proposal.

Personally I think that dry States should be protected from the importations of liquor into them, and that the law should be enforced.

Senator LEE. Now, may I call your attention to the fact that this letter of Mr. Logan was written November 22, and in it he writes—I quote again:

> A few weeks ago, after we had just picked up two truck loads of whisky * * *.

Therefore, the United States marshal was continuing to prosecute liquor violators under the 1936 act, but he writes me November 22, that only a few weeks before that he had picked up two truck loads of whisky. I call this to your attention to further substantiate the statement that it was the opinion of the Federal officers, contrary to the memorandum issued by the general counsel in February, 8 months before, that the Liquor Enforcement Act of 1936 did prohibit the importation of liquor.

You will see from these two quotations, one from the United States Marshal of the Northern District of Oklahoma, who continued to enforce the law against liquor violators after the memorandum issued by the Treasury Department, and the Assistant District Attorney of the Eastern District of Oklahoma, who also continued to prosecute violations of the liquor law after the Treasury Department had announced that the Liquor Enforcement Act of 1936 did not apply.

Now, to continue the letter from United State Marshal John Logan:

> A few weeks ago, after we had just picked up two truck loads of whisky, Captain Burkett, who represents the alcohol tax unit for several States, came here and held a conference with the United States Attorney Mauzy and myself

with regard to the matter and brought an opinion from Washington that we should not any longer molest these importers because of a certain act passed later which cast some doubt upon the authority to do so.

That answers your question, Senator King, as to why we could not go ahead. It was because they sent down and had the district attorney and marshal to stop molesting them as they brought in the liquor. He said:

So I gave orders to my men to not trouble importers of intoxicating liquor.

Senator CONNALLY. Is that prosecuting for not paying tax?

Senator LEE. No; for bringing it into the State in violation of the law. He continues:

Of course, had the second act (referring to the Liquor Enforcement Act of 1936) not been passed, the first act (that is, the liquor law of 1934) is sufficiently clear and plain enough so that the marshal's office would clearly understand what his duty was and could enforce it against all importation into Oklahoma.

That is the law of 1934, but the law of 1936, according to the Treasury Department, repealed that. In other words, according to the decision of the Treasury Department, the Liquor Act which Congress passed in 1936, repealed instead of strengthened the prohibition laws that protected dry States.

Therefore, let me ask you: Do you think that the members of Congress intended to repeal protection from the dry States? The courts in interpreting laws quite often look to the intent and spirit of the law. In this regard I wish to quote from a few decisions referred to in a brief prepared by Judge Sam H. Lattimore, Assistant Attorney General of Oklahoma.

In *Ozawa* v. *United States*, 360 U. S. 178, 67 L. edition 199, 43 S. Ct. 65, the Court said:

"It is the duty of this court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance; but if this leads to an unreasonable variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment, and inquire into its antecedent history, and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail."

In *Barrett* v. *Van Pelt* (268 U. S. 85, 69 L. ed. 857 45 S. Ct. 437), the Court said:

"The court will not be prevented from giving effect to a legislative intention of which it is satisfied by a too rigid adherence to the very word and letter of the statute."

In *Southern Surety Co.* v. *United States* (23 Fed. (2d) 55), the Circuit Court of Appeals, Eighth Circuit, in an opinion by Judge Sanborn, said:

"One of the cardinal rules for the construction of a statute is that it must be given a rational, sensible construction, and that, if this be consonant with its terms, it must have the interpretation which will advance the remedy and repress the wrong."

In *Rodenbough* v. *United States* (25 Fed. (2d) 13), the Circuit Court of Appeals, Third Circuit, stated the rule as follows:

"The fundamental of statutory construction is that courts should ascertain and give effect to the intent of the legislative body. When, because of doubtful language in a statute, two possible intentions appear, the courts must select the one which is rational and sensible, and which bears most directly on the object which the legislative body sought to obtain, or the evil which it endeavored to remedy or avoid."

Now, with reference to the Liquor Act of 1936, does anybody believe that it was the intent and purpose of Congress to pass a law that did not apply to a single State in the Union, so far as protection is concerned, but one that repealed the protection for the dry States

that we were already receiving? And yet that is the interpretation placed upon this statute by Mr. Oliphant, the General Counsel of the Treasury Department.

The decision itself is not one that would be readily agreed to. Judge Sam Lattimore, Assistant Attorney General for the State of Oklahoma, has prepared a very able brief and filed it in the Tenth Circuit Court of Appeals in which he disagrees vigorously with the opinion of the general counsel of the Treasury Department. I wish to quote a reference from that brief:

Again it was the defendants and not the Government who contended that the Federal act was not applicable. It was argued that before the Reed amendment could be applied, the laws of Tennessee must establish absolute and complete prohibition of intoxicating liquor without exception. The district court refused to so hold. The conviction of the various defendants was affirmed by the circuit court of appeals. We quote merely the first paragraph of the syllabus, which is as follows:

"To render the Reed amendment (Act March 3, 1917, sec. 5 (Compt. St. 1918, secs. 8739a, 10387a-10387c)), prohibiting the transportation of liquor in interstate commerce, except for certain purposes, into any State 'the laws of which prohibit the manufacture or sale therein,' of liquors for beverage purposes, applicable to a State, it must have adopted a general policy of prohibition throughout its territory; but it is not essential that such prohibition should be literally without exception."

That is right in the face of the General Counsel's decision.

Senator KING. May I ask you a question?

Senator LEE. Yes.

Senator KING. You have State statutes that are dry in character?

Senator LEE. Yes.

Senator KING. That is, statutes prohibiting the transportation and sale of intoxicating liquors?

Senator LEE. Yes.

Senator KING. Have you, notwithstanding the opinion of Mr. Oliphant, gone ahead and tried to enforce your State laws?

Senator LEE. Oh, yes, we have.

Senator KING. In the State courts, I mean.

Senator LEE. Yes.

Senator KING. Why cannot you enforce the law?

Senator LEE. When they are coming in truck loads and they are armed with these Federal licenses, 339 of them in one district, and they can sell to them because they have got the Federal licenses, why, it is an impossible task.

Senator KING. It seems to me that your district attorney or your attorney general ought to enforce that State law.

Senator LEE. We are doing our best.

Senator KING. Your attorney general ought to enforce the State law and tell the Federal Government to go to pot if they interfere with the State law, because with the repeal of the eighteenth amendment it restores the matter to the State and the State can pass a law interdicting the transportation and sale of intoxicating liquors into the State. It seems to me you ought to enforce your own law.

Senator BULKLEY. I think we are pledged to help the State.

Senator KING. I agree with you. I see no reason why the State should not enforce their own law.

Senator BULKLEY. They should, but we have to do our part, too.

Senator LEE. It is rather difficult for a State officer, when the Federal Government has offered them an invitation to go ahead and ship in, and then arm them with licenses. I ask you if that is in

keeping with the President's statement, saying, "We, as Democrats, must and will, rightly and morally, enable the States"? Is that enabling them? Then the Democratic platform says, "We demand that the Federal Government effectively exercise its power to enable the States to protect themselves." I have a letter from the district attorney that says they absolutely are clogging the highways with bootleg liquor.

Senator BARKLEY. But they have Federal licenses authorizing the shipment and sale.

Senator LEE. I never saw one.

The CHAIRMAN. They were issued to protect the fellow in the State from prosecution by the Federal Government. We amended the law the last time and the Supreme Court, I understood, or some court, passed on the proposition that they could not, in dry States, issue these licenses.

Senator LEE. They ought to be issued so that they are null and void and revoked when used in dry States.

Senator HERRING. You are right; they do issue those in States where it is contrary to the State law.

The CHAIRMAN. The Supreme Court invalidated the law that we passed.

Senator BARKLEY. They held it unconstitutional.

The CHAIRMAN. That is what I wanted to ask the Department about.

Senator LEE. Assistant District Attorney Charles N. Champion writes me under date of February 14, 1938, as follows:

> On December 21, 1936, the United States grand jury in the eastern judicial district of Oklahoma returned an indictment against one Ermon Dunn, charging him with introducing and transporting 45 cases of tax-paid liquor from Fort Smith, Ark., into the eastern district of Oklahoma. Dunn was tried and convicted in the Federal court and sentenced to serve 1 year in prison and assessed a fine of $1 on execution. Dunn appealed from the judgment and sentence to the tenth circuit court of appeals and on appeal raised only one ground for reversal of the case, and that was that the search and seizure of his automobile by Federal officers without a search warrant was unlawful and a violation of his constitutional rights.
>
> In September 1937 I went to Denver, Colo., and appeared before the circuit court of appeals and argued this case. No question was raised by the defendant as to whether the act was applicable or enforceable in Oklahoma. After this case had been argued before the circuit court of appeals the attorney general instructed this office to file a supplemental brief in the *Dunn case* presenting the views of the Treasury Department as disclosed by the ruling of the general counsel.

Here we see the unprecedented situation where one arm of the Government, an administrative arm, set up to enforce the law in opposition to the belief on the part of Congress that the law prohibited importation in dry States, in opposition to the belief on the part of the district attorneys and the United States marshals that the law prohibits the importation of liquor, in opposition to the belief on the part of the liquor racketeers, in opposition to the belief on the part of the people of the United States that dry States are protected from the importation of liquor, and in opposition to the presumption in favor of every law, until that presumption has been over ruled by a court of law, we see the arm of the Government charged with the enforcement of a law, securing the aid of another arm of the Government, namely, the Department of Justice, in this unprece-

dented beating down of a law, in this unheard-of nullifying of a law without court decision.

In this case what was the defendant's claim for appeal? Was it that the 1936 Liquor Enforcement Act was not applicable? No; he appealed on other grounds. It was left for the Government that should have been the champion of the law to come forward in defense of the defendant, the violator of the liquor law, with a supplemental brief in which it is argued that the law is null and void.

Let me ask you if this is in accordance with the party pledge, which says:

We demand that the Federal Government effectively exercise its power to enable the States to protect themselves against importation of intoxicating liquors in violation of their laws.

Do you think in this case the Federal Government is effectively exercising its power on the side of the States in their efforts to protect themselves against the importation of liquor? On the contrary, this arm of the Federal Government is effectively exercising its power to beat down the law.

Then, again, may I quote the language of the President, in which he said:

We, as Democrats, must and will, rightly and morally, enable the States to protect themselves against the importation of intoxicating liquors where such importation may violate their State laws.

Again contrast in your mind this language with the attitude of the Treasury Department in removing protection from the States. Then call to mind again the vigorous, clear, unmistakable language of the twenty-first amendment, which says that the transportation or importation into any State of intoxicating liquors in violation of the laws thereof is hereby prohibited.

Then, again, picture for yourself the situation of the legislative branch of the Government being entirely thwarted in its purpose by the executive branch of the Government, to whom Congress looked for enforcement, assuming the role of judge and nullifying the act of Congress by stating in effect that Congress has passed a silly law which has no meaning. It has no effect. It does not apply to a single State or Territory. It is a dead letter. Congressmen and Senators who support it have been made to appear foolish by passing a law that has no effect. This law does not apply to a single State in the Union. We passed a farce, a null, a nothing.

Is it your opinion that the Senators and Congressmen who voted for the Liquor Enforcement Act of 1936 had in mind that it was to have no effect other than to repeal Federal protection from dry States? It is my contention that Congress fully intended that this law be put into effect—the twenty-first amendment—which guarantees protection to the dry States.

May I ask you to go a little further with this contrast of how the Treasury Department has nullified the pledge of the party, the pledge of the President, the constitutional amendment, and the act of Congress, by calling your attention to the letter of United States Marshal John Logan in which he points out that in his district alone, the Northern Judicial District of Oklahoma, there are 339 Federal liquor permits or licenses, and that there are 176 in the city of Tulsa alone. These permits are furnished by the Treasury Department.

May I read another paragraph from United States Marshal Logan's letter:

Another thought along this line that would stop the importation of whisky into Oklahoma also would be an act to prohibit the Treasury Department from selling a revenue license for the sale of intoxicating liquor in dry territory. As it is, as I have stated, there are 339 dealers in this district who have revenue licenses and who sell tax-paid whisky; that is, whisky that has been made in outside States legitimately under the revenue law and bears the proper revenue stamps. If the revenue department was not allowed to sell revenue licenses to whisky dealers, then the marshal's office could stop all sale of tax-paid whisky in a dry State, whereas the State authorities now seem to pay but very little, if any, attention to it.

Let me ask you is the sale of these liquor licenses which permit the holders to sell liquor in dry States in keeping with your idea of how the Federal Government should effectively exercise its power to enable the dry States to protect themselves, or is that in keeping with President Roosevelt's words when he said, "We, as Democrats, must and will, rightly and morally, enable the States to protect themselves," or is it in keeping with the letter or spirit of the twenty-first amendment? On the contrary, it is a violation of all three.

Now, add to that the fact that without challenge or lawsuit, without provocation, the Treasury Department announced to the world that the dry States have no Federal protection, that liquor can be brought into the States in violation of State laws, and we will furnish liquor licenses to those who wish to sell liquor in these States, and the States are helpless, because we have notified the Federal officers that they are not to raise a finger.

Senator VANDENBERG. Did you say that was a Treasury announcement?

Senator LEE. I am paraphrasing it. Yes; that is a Treasury announcement. That is what it amounts to. They told the Federal officers, the district attorney, and the marshal, without securing the aid of the Justice Department in doing it, they told them not to make arrests, not to file cases, and not to touch these fellows.

Senator CONNALLY. Senator, when you complain about issuing Federal licenses, in my State, under prohibition, the issuing of Federal licenses has helped the State to enforce the law, because all the State had to do was to introduce the Federal license. That raised the presumption that the fellow had engaged illegally in selling liquor. If they did not issue the licenses you would not have that proof.

I believe we ought to protect the dry States, but I am just making the point that the Federal Government, in issuing a license, does not necessarily license the violation of the State law, it just taxes his Federal business. The State can come in and prosecute him if he violates the State law.

Senator LEE. We have got a case there of a man with 45 cases of liquor. The grand jury of the district did its part. The Government itself initiated the defense for Ermon Dunn who was facing a penitentiary sentence of 1 year. A United States marshal had arrested Ermon Dunn, had caught him red-handed with 45 cases of liquor; the district attorney had done his duty; the Federal court had done its duty, and the criminal had appealed on the ground that the search and seizure was without warrant, but the criminal now has a strong champion on his side. The Attorney General of the United States has directed the district attorney to file a supplemental brief in behalf of the liquor violator.

Now, therefore, I submit to you that the dry States are now without protection from the Federal Government and that the Treasury Department that prepared in large part, if not altogether, the language of the Liquor Enforcement Act of 1936, and then declared it null and void in 1937, is entirely out of harmony in its attitude with the pledge of the party, the President, and the twenty-first amendment; and, further, that liquor is flooding the State of Oklahoma in violation of our laws, and that the Federal Government is giving no protection. Not only is the Federal Government giving no protection, but the attitude of the Treasury Department is aiding and abetting the violation of our laws.

Our legislature will not meet for a year; therefore, we must look to the passage of this amendment for the protection of the States in keeping with the pledge of the party, the President, and the twenty-first amendment.

This amendment will give dry States protection. The third contention is that this amendment will give the dry States that protection. It is in keeping with the Liquor Enforcement Act of 1936. It simply plugs a technical leak created by the voluntary decision of the Treasury Department. It is in full keeping with the language of the twenty-first amendment. It simply, in the language of the amendment itself, says that:

(a) Whoever shall import, bring, or transport any intoxicating liquor into any State in which all sales (except for scientific, sacramental, medicinal, or mechanical purposes) of intoxicating liquor are prohibited, otherwise than in the course of continuous interstate transportation through such State, or attempt so to do, or assist in so doing, shall, if the importation, bringing, or transportation of such intoxicating liquor into such State is prohibited by the laws thereof, be guilty of a misdemeanor and shall be fined not more than $1,000 or imprisoned not more than one year, or both. All intoxicating liquor imported, brought, or transported into any such State, otherwise than in the course of continuous interstate transportation, through such State, except when consigned to a dealer in intoxicating liquor for scientific, sacramental, medicinal, or mechanical purposes, shall be presumed to have been imported, brought, or transported into such State contrary to the provisions of this section, and the burden of proof shall be on the claimant or the accused to rebut such presumption.

(b) For the purposes of this section "intoxicating liquor" shall be defined in the manner in which it is defined by the laws of the State into which it is imported, brought, or transported.

Now, may I summarize my arguments. First, I have pointed out that this administration is committed to the protection of dry States from the importation of liquor as evidenced by the language of the twenty-first amendment which says—

The transportation or importation into any State, territory, or possession of the United States for delivery or use therein, of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

Second, I have shown that due to the voluntary striking down of the Liquor Enforcement Act of 1936 by the Treasury Department, the States are left without Federal protection from the importation of liquor.

And finally, I submit that this amendment will give protection to the dry States, and I ask that it be accepted by the committee.

The CHAIRMAN. We will meet this afternoon and hear the views of the Treasury Department on this proposal.

AFTERNOON SESSION

(The hearing was resumed at 2:30 p. m., at the conclusion of the recess at noon.)

The CHAIRMAN. Mr. Magill, you heard the statement of Senator Lee this morning with reference to the failure of the Government to cooperate in the matter of law enforcement, and you heard what he said with reference to Mr. Oliphant's opinion. Do you desire to say anything with respect to this matter, or will some other representative of the Treasury Department make a statement?

Mr. MAGILL. I have asked Deputy Commissioner Berkshire to come up here, who was in charge of the Alcohol Tax Unit, because I think that he is thoroughly familiar with the situation.

The CHAIRMAN. All right, Mr. Berkshire.

STATEMENT OF STEWART BERKSHIRE, DEPUTY COMMISSIONER OF INTERNAL REVENUE, TREASURY DEPARTMENT

Mr. BERKSHIRE. Mr. Chairman, the Liquor Enforcement Act of 1936, passed on June 25, was passed after careful consideration by officials of the Treasury Department and after careful study by members of committees of Congress. It was drawn in an effort to get away from some of the obnoxious provisions of prohibition, the prosecutions for small possession cases, and an endeavor to stop liquor at the State line, to obviate the necessity of an investigation of each and every shipment as it approached and crossed the State line. It was intended that the State do something if it really wanted protection from the Federal Government.

The administration did promise, I take it, to enable the State to protect itself. I think that is the language as quoted by the Senator, not that the Federal Government would build about every dry State a wall and thereby prevent every shipment into that dry State—an impossible task, we take it.

So it was believed that if the State, if it is really dry, could either prohibit all importations of liquors within its borders or if it desired to permit importations for certain purposes, excepted legitimate purposes, such as medical, sacramental, scientific and mechanical purposes, that it put a permit requirement on those importations. They would not be many, and it would not be a difficult problem for the State to enforce. We have never had any objection from any dry State to the provisions of this act.

Senator HERRING. I want to make one right now then.

Mr. BERKSHIRE. There has been no reason presented, and we have conferred with present officials from States why this might not reasonably be met, Senator. It is the Treasury Department's considered opinion, not only from the standpoint of the possibility of adequate enforcement by the Government, but from the standpoint of efficient and adequate protection of the State, if the State wants it, that the present act be utilized, and we believe that the State might get protection by meeting these simple requirements.

Senator BAILEY. How can the State get protection when the United States Government has full control of the instrumentalities of interstate commerce and permits the shipment of liquor into the prohibition State? Now, you answer me that. You say we could get the protection. How could we get protection under those circumstances?

Mr. BERKSHIRE. Under the present law, Senator?

Senator BAILEY. I just want to know how we would get the protection.

Mr. BERKSHIRE. It is thought they would get it under the present law, if the State of Oklahoma, as an illustration, either prohibits all importations or chooses to authorize the importation for medicinal purposes, as it does, and requires that these importations be accompanied by permits. Then the officer may determine when he finds an importation approaching the border or anywhere within the State on the way to one of these legal dealers, if it is accompanied by a permit, he knows immediately whether there is a violation without following that shipment to determine whether or not somewhere it is going to violate some law of the State. The mere finding of the shipment crossing the State border without something to indicate that it is for a legal or an illegal purpose in itself is not a prima facie case, and no reason for seizure—no probable cause to seize the shipment.

Senator HERRING. Mr. Chairman, we are not blaming the Treasury Department, because I think they are carrying out the terms of the law; but I would like to have someone justify to me the selling of permits and taking money for them within my State to do a thing which is illegal and not permitted under the State law. We have none of those things.

The CHAIRMAN. That is the thing that I thought the act of 1936, that we passed, prevented. We tried in the law, because I know that I offered the amendment—and did not the Supreme Court come in and invalidate that law?

Mr. BERKSHIRE. No, sir; I don't think so, Senator.

The CHAIRMAN. What is the situation with respect to that?

Mr. BERKSHIRE. The situation with respect to the sale of stamps, Senator, in all States?

The CHAIRMAN. I know I have had that general complaint in my State.

Senator BARKLEY. It has never been regarded as a permit. I remember when I ran for Congress the first time, I advocated the passage of a law that would prohibit the issue of a permit by the Federal Government to sell liquor in dry territory.

Senator HERRING. That is what I should like to have explained.

Senator BARKLEY. The court held that it was not a permit, that it was a tax levied upon the sale of the liquor of the dealer, whoever he was.

Senator HERRING. He is not permitted to sell it.

Senator BARKLEY. No; it is not regarded as a permit.

Senator HERRING. It authorizes a tax on an illegal act.

Senator BARKLEY. If he sells liquor without paying the tax, he is violating the laws of the United States, and so every time a man is indicted in a Federal Court, he is indicted for an offense described as selling spiritous or malt liquors without the payment of the tax required by the Government. That was the difficulty. I tried to get legislation of that sort, but I could not do it, because it was not regarded as a permit. It is not now regarded as a permit; it is merely a collection of a $25 tax levied upon a man who is engaged in the sale of liquor.

Mr. BERKSHIRE. That is right.

Senator KING. In my State, the State has control of the liquor, but many persons there have a license, one of these certificates.

Mr. BERKSHIRE. Stamps.

Senator KING. They are prosecuted under the State law if they are violating it.

Senator HERRING. But there are 2,000 people paying a tax to do something which is illegal under our law.

Senator KING. When a man has one of those licenses or whatever it is from the Federal Government, we used to regard that as prima facie evidence that he is violating the State law.

Mr. BERKSHIRE. This is a receipt and not a license [reading from a tax receipt]:

> The payment of the tax imposed by the internal-revenue law shall not be held to exempt any person from any penalty or punishment provided by the laws of any State for carrying on the same within such State or in a manner to authorize the commencement or continuance of such trade when it is contrary to the laws of such State.

Senator HERRING. Why should you take money from a man when you know that he is prohibited by the State law from doing the thing that you are collecting the money for?

Mr. BERKSHIRE. The statute imposes the tax on the individual, not the individual in Oklahoma or Texas or New York, but every individual in every State. In other words, to satisfy the uniformity provisions, as I understand it, it has got to be left in just that way. The Supreme Court in the *Constantine case* (296 U. S. 287), when it overruled the penal provisions of the statute imposing a $1,000 tax on a person who carried on the business of selling liquor in a dry State, the Court in that case said that it was unconstitutional with respect to the $1,000, but that the $25 that he had paid was paid properly, and in accordance with the law.

Senator GUFFEY. Who drafted this? Mr. Oliphant, or Mr. Alexander, or what Treasury official?

Mr. BERKSHIRE. It was prepared in the Treasury Department.

Senator GUFFEY. They prepared it with the idea of enforcing the liquor law in dry States?

Mr. BERKSHIRE. Yes, sir.

Senator GUFFEY. And Mr. Oliphant writes a letter saying that they cannot enforce it, is that right? According to Senator Lee's statement?

Mr. BERKSHIRE. You are speaking now of the opinion that Mr. Oliphant rendered with respect to whether or not this act applied to Oklahoma?

Senator GUFFEY. That is the case I have in mind.

Mr. BERKSHIRE. Yes.

Senator LEE. Does it apply to any dry State?

Mr. BERKSHIRE. It does not apply to any State and it was not contemplated that it should unless its requirements were met.

Senator LEE. It was intended to repeal the law of 1934?

Mr. BERKSHIRE. It did repeal the law, necessarily by implication as it did by express provision as I understand; yes, sir.

The CHAIRMAN. Let me ask you if this is the law that you have reference to. This section 403, special excise tax on carrying on liquor business. Is that what you are discussing?

Mr. BERKSHIRE. That is 701, is it not, Senator?

The CHAIRMAN. Yes.

Mr. BERKSHIRE. Yes, sir.

The CHAIRMAN. Is that the same matter that the Supreme Court passed on?

Mr. BERKSHIRE. It held that the penal provisions of section 701 were unconstitutional, but that the provision which levied a tax of $25 on every dealer whether in a dry State or not, was legal and proper.

Senator GUFFEY. That is not a new tax, that $25?

Mr. BERKSHIRE. No.

Senator GUFFEY. And there it put a revenue license on?

Mr. BERKSHIRE. That is right.

The CHAIRMAN. What is the opinion of the lawyers who have looked into this matter with reference to repealing the right of the Federal Government to sell these permits that you have as an exhibit here, in dry States, in States where the law has said that liquor could not be sold? It is a difficult matter for some of us to explain to our constituents—after we passed the constitutional amendment to say that the dry States were going to be protected, and the Federal Government is now issuing these permits in those dry States. I have not been able to explain it. I do not see any logic in it.

Senator CONNALLY. Mr. Chairman, let me suggest right there. I do not regard the Government doing that as really a hindrance to the enforcement of the State law, because the law requires that you post it in the place of business, does it not? The license?

Mr. BERKSHIRE. Yes.

Senator CONNALLY. If you go into a bootlegger's place, the first thing you would see is a Federal liquor license which is presumptive evidence.

Senator HERRING. Here is the hindrance in that. You know that the bootlegger does not fear the State authority like he does the Federal authority. And the possession of that permit by him is something that is difficult to reconcile.

Senator CONNALLY. On the other hand, suppose he does not pay that tax at all. Suppose the Federal Government does not tax him? You have not got anything more on him.

Senator HERRING. Surely you have.

Senator CONNALLY. What have you?

Senator HERRING. Perhaps the Government will cooperate with us then. He thinks that he is taxed by the Government to violate our law.

Senator CONNALLY. I am in favor of the Webb-Kenyon Act. Has that been repealed?

Mr. BERKSHIRE. Yes, sir; but reenacted.

The CHAIRMAN. When?

Mr. BERKSHIRE. They never had a penal provision in that, Senator, in the first place.

The CHAIRMAN. But I can understand Senator Connally's proposition that a fellow is foolish to go into a dry State and get one of these permits, because it is evidence as against the State authorities prosecuting him for violating the law. It almost makes a prima facie case, and yet, so far as my State is concerned, the overwhelming evidence is, and you cannot convince them otherwise—why should the Federal Government issue these permits in dry territory?

Senator CONNALLY. It is not a permit; it is a mere license; it is a tax.

The CHAIRMAN. Well, that is the situation.

Senator CONNALLY. In my State, where they are allowed to sell liquor, you tax him. You put a $25 tax on the fellow that is in the business of selling liquor, and why should you exempt him in Oklahoma or any other State and not in my State?

Senator HERRING. Because our drug stores do not sell liquor. Under our State law, he does not sell it.

Senator CONNALLY. But he is subject to the Federal tax. I want to help the dry States, but I do not regard the issue of this $25 tax as a hindrance to the enforcement of the State law.

Senator HERRING. It has been with us.

The CHAIRMAN. It does not show that the Federal Government is cooperating with the dry States in the enforcement of this law.

Senator BAILEY. If we give notice to the State that we have sold this license to a man in the State, and now if the State wishes to enforce its prohibition laws, all it has to do is to say that the possession of this license is prima facie evidence of having liquor in the State. Why does that not put the burden on the State, and at the same time give them full authority to control this liquor traffic as far as the State could go?

The CHAIRMAN. That would be very helpful in the prosecution by the States.

Senator KING. No man can show this license and plead that as immunity and plead that as protection from violation of the State laws. I would like to ask Senator Lee, as I did this morning, why they did not go ahead and enforce their own State laws? The trouble is that the State wants us to enforce their State laws.

Senator HERRING. No; they do not.

The CHAIRMAN. Why are we maintaining a prohibition force, maintaining great numbers of agents in the Government service and they are in my State, which is a dry State; why are we doing it if they are not going to render assistance to the State authorities in the matter?

Senator KING. It is not the obligation of the Federal Government to enforce State statutes.

Senator BULKLEY. I think what Senator King said is exactly right. I should think that a sale of liquor in a State in violation of the law of the State is not a violation of the Federal law at all, but I do not think Senator Lee's proposition goes to that. It is directed to the proposition of shipping liquor into the States, and that is our business, and it is expressly in the Constitution that it is unlawful to do that.

The CHAIRMAN. I thought that was prohibited by the Webb-Kenyon law, and you say that was repealed and there was no penalty attached to it?

Mr. BERKSHIRE. That is correct, Senator.

Senator GUFFEY. What I cannot understand is why they passed this law at the suggested recommendation of Mr. Oliphant, and then Mr. Oliphant turns around and writes an opinion that we cannot enforce it, when he has not had a court opinion.

Senator KING. He has not said that they cannot enforce the State laws.

Senator GUFFEY. He said it cannot apply to Oklahoma. And Oklahoma is a dry State. I have all of the sympathy in the world for Senator Lee in his position.

Mr. BERKSHIRE. Let me clarify that position just a little bit.

Senator CONNALLY. As I view it, we could do this. The Federal Government could certainly prohibit shipping in interstate commerce any liquor into a dry State, but that is not a tax matter. That is a police regulation. We do not like to mix up taxes with police regulation.

Mr. BERKSHIRE. Now, Senator Guffey, at the time the bill was passed, certainly these committees went into this matter very, very carefully. Here is what the House Judiciary Committee had to say:

> The determination of whether an offense has been committed turns upon the existence of a State permit system or a complete embargo on all bringing of liquor into the State. In the former case, it will be an offense to ship intoxicating liquor unaccompanied by permit or license in the State. In the latter, it will be an offense merely to transport such liquor into the State.

Now, from the reports of the committees, it was certainly the definite notion of the committee, and we will take it of Congress, that unless the State had the permit system, it would not apply to that State. Oklahoma does not have a permit system. It did not take a great lawyer to write that opinion, I take it. Here is the way that that happened.

We had a letter from our supervisor asking us whether or not they should take over certain cases, certain seizures being made down there by United States marshals, and here was the predicament we found ourselves in: We were taking those seizures and we were disposing of property of individuals, automobiles. We knew that Oklahoma did not have any permit system, and we felt like we did not want to be disposing of automobiles under an act we did not think applied, and we asked for an opinion. The opinion was broadcast, and it was used I think in the trial of some case. It had no more weight, I take it, than the merits that it contains. It was not being used to cut under Oklahoma and take advantage of anyone. It was merely presented for what it was worth, and I take it that any lawyer or any man present can read the act, and I think it would be conceded that this law does not apply to the State of Oklahoma if it does not have a permit system.

Senator KING. But it does not supersede the State law, and the State could prosecute any man who violated the State law.

Mr. BERKSHIRE. Certainly.

Senator LEE. Mr. Chairman, may I ask a question there?

The CHAIRMAN. Yes.

Senator LEE. What was that third paragraph written for? It applied to any State.

Mr. BERKSHIRE. It was certainly contemplated—it was known, of course, that it did not apply to any State. At that time we had a number of dry States. Many have gone wet since. That law has been on the books since June 25, 1936. I do not believe the Senator will contend that if they had a legislature tomorrow to pass an act putting a permit provision on importations, which this legislation authorized, that they would have any difficulty, and you would have a smooth working piece of machinery to do the job——

The CHAIRMAN (interposing). As I understand Senator Lee's contention it is that his State is dry and he wants the cooperation of the Federal Government in being maintained dry, if possible. Now, the Webb-Kenyon law which was passed a great many years ago—I voted for it—I understand that it has not been repealed. You said that it

has been. These other gentlemen here say that it has not been repealed, but I understand that it had no penalty. The Webb-Kenyon law prohibited the shipments of liquor from one State into another, from a wet State into a dry State

Senator CONNALLY. Here is what it did, if you will permit me. It made liquor shipped in interstate commerce subject to State laws when it reached the boundary. It did not specifically make it a Federal offense as I understand it, but it took away the interstate character of a liquor shipment when it went across the State line. It then became subject to the State law. Under the old law, if it was an interstate transaction, the State could not do anything about it.

The CHAIRMAN. That may be right. I knew it left to the States the jurisdiction of this matter. But why could the law not be considered by the proper and appropriate committee, to put teeth in the law whereby liquor shipped from a wet State into a dry State would suffer a certain penalty? Wouldn't that get at what you are trying to get at?

Senator LEE. Yes, Mr. Chairman; but let me ask the witness. There are in effecting three bills pending now—this amendment and a bill that passed the House known as the Carver bill, which simply reworded the twenty-first amendment and passed the House and has been before this subcommittee for nearly a year now.

The CHAIRMAN. Before a subcommittee of this committee?

Senator LEE. Senator King is the chairman.

Senator KING. Only appointed at this session of Congress, however.

Senator LEE. Now, I want to ask the witness: Do you or the Treasury Department favor any of these three proposed bills?

Mr. BERKSHIRE. No, sir; we do not. I think we have a better law now on the statute books.

Senator LEE. There is your answer. The situation is, Mr. Chairman, that they are against any Federal law which will make the Federal Government have to do anything. If our State legislature were in session, I would ask him—I don't know that they would do it—but I would ask them to pass a law that would meet the requirements as Mr. Oliphant lays them down. No State has done that, but it is a year until our legislature meets, and the Treasury Department is going to oppose the passage of any bill, Mr. Chairman, and I believe this is appropriate to this bill. I would not even strain a point. It goes to the same department that will have charge of it, and this would immediately effect the cure, whereas the other way we will be met by opposition by the Treasury Department on every hand. They oppose everything except making the States write the law like they say they have got to write it.

Senator KING. Let me ask you a question there, if I may, Senator. You have a law in your State forbidding manufacture, sale, or transportation of intoxicating liquors, have you not?

Senator LEE. Yes.

Senator KING. If I should carry into your State a jug of liquor, I could be prosecuted under your State law. If I should open up a saloon there or some sort of a bawdy house or anything else where I sold liquor, I could be prosecuted under your State law?

Senator LEE. Yes.

Senator KING. There is nothing in Mr. Oliphant's letter and nothing in the attitude of the Federal Government to interfere with your State laws. Why don't you enforce your own laws?

Senator LEE. Does the Senator not favor Federal aid to help keeping the liquor from coming in? I am sure the Senator does, as he has expressed himself. Human nature is human nature. And it is announced to the world that the Federal Government is not doing anything about it.

Senator KING. Let me interrupt you again, Senator, if I may. In my State, we had prohibition for a number of years before the eighteenth amendment. We enforced the law. We did not have any trouble at all, and after the Federal Government passed the eighteenth amendment and took it over, we had lots of trouble and the State ceased to function. But when the responsibility rested upon us to enforce our own laws, we enforced them, and we drove the bootleggers and drove the saloon people out of the State, and we had a dry State. Why don't you enforce your own law instead of devolving upon the Federal Government for the enforcement of your own statutes?

Senator LEE. I take it then that the Senator is opposed to any Federal aid, and he is chairman of the committee, so, Senator, you see how much chance I have to get the bill out there.

Senator KING. I will promise you a fair hearing.

Senator LEE. Will you promise me a favorable report?

Senator KING. I will say that I do not promise you now an unfavorable one. [Laughter.]

Senator GEORGE. May I make a statement about this matter?

The CHAIRMAN. Yes.

Senator GEORGE. I can see very well why the Federal Government through the Treasury Department and the Alcohol Control Board, whether it is a separate bureau or comes in under the Treasury, why it would be very loathe to go back into the business of running down bootleggers and prosecuting them. We had that experience when we had the eighteenth amendment. Now, there is a bill—I am not saying this by way of opposition to Senator Lee's bill—there is a bill before the Judiciary Committee—perhaps two. When the subcommittee meets to consider it, I propose to offer an amendment giving the Treasury plenary power to cancel permits and licenses, wholesalers and retailers, who sell liquors for shipment into a dry State or who permit it to go out of their place of business charged with knowledge or chargeable with knowledge that it is destined for consumption in a dry State. I think that could be effective and fall properly within the regulatory power that the Treasury might enforce without involving the Government again in this running down of individual bootleggers and prosecuting them, and I have been waiting for the subcommittee of the Judiciary Committee to meet so that I could go in and offer this amendment.

Senator CONNALLY. Senator George, may I suggest just there, that I am informed that when a man takes out one of these licenses in a dry State, it is not only posted in his place of business, but it is posted in the office of the collector of internal revenue. If that is true, the State law enforcement officers could go in to the collector of internal revenue and get a list of everybody that has got these licenses, and then just march in on them and nail them.

Senator GEORGE. That is true. That has to do with the State's enforcement of the police power. I can see a great virtue in that. I think our experience under the eighteenth amendment ought to have taught us a great many things, but I think the Federal Government should exercise the plenary power revoking the licenses, because they all have to have that license.

Senator HERRING. They have that power now.

Senator GEORGE. Yes, I know; but it is not as specific as it ought to be, and I think Congress should go as far as it can to say absolutely that when shipments go into these dry States, any State whose law prohibits the sale of intoxicants or whenever the wholesaler or distributor has reason to believe that it is going there, that then it shall be mandatory on the Treasury to forfeit his permit and his license. I think that will do the dry States more good than anything else, and I think it will keep the Federal Government in their proper field of activity.

The CHAIRMAN. If there were such a law as that, the Department of Justice would have the duty to enforce it. They would have to enforce that Federal law.

Senator GEORGE. They would enforce it through the license system, I think. It is not in opposition to Senator Lee's bill that I made that statement. I merely made it because it represents my own best view of how the thing ought to be handled, and as I say, I expect to go before the Judiciary Committee as soon as it takes up this matter.

The CHAIRMAN. We have several members of the Judiciary Committee here.

Senator KING. May I say that the bill before the subcommittee of which I am the chairman, that that bill will be taken up as soon as we get through with the tax bill, and we will be glad to receive the views of anybody. I have an open mind. I will say frankly that I only feel that the State ought to enforce its own law and not devolve responsibility upon the Federal Government.

Senator LEE. I would not ask to have the State shirk any of its responsibilities in that regard, but I do not want that job to be doubled as it is in the case now because of the attitude of a Federal arm of the Government. May I say that I have talked to Mr. Cogan of the Treasury Department and he tells me that the report on that bill before your committee is in process and that it will be unfavorable for two reasons, because they think that it is unconstitutional, and because they think it is impracticable of application. So you see the only chance I have got to plug this leak is through this channel. They are going to oppose any move except for Oklahoma to change its laws to fit their views.

Senator CONNALLY. You are assuming that the Judiciary Committee will do what the Treasury tells them. That does not necessarily follow. Some of us do not obey the departments.

Senator LEE. We cannot expect to write a law that would be approved by the Treasury Department, a law that would do any good. Here is a statement from the Judiciary Committee on the congressional intent of that law that most of us here voted for and thought that we were voting for a law to effect the carrying out of the twenty-first amendment, instead of a law to repeal the law of 1937. This is the House Judiciary Committee report:

It is to enforce the twenty-first amendment to the Constitution of the United States which was declared to be effective on December 5, 1933, and which guar-

antees Federal protection to dry States against liquor law violators directed from outside their borders.

That is the congressional intent written into the Judiciary Committee report of the House.

The CHAIRMAN. Well, Senator Lee, I think this committee understands it exactly, and so far as I am concerned I am in sympathy with the objects that you have in mind, but I do think that this matter ought to be attended to by the Judiciary Committee. I am in sympathy with some legislation that will protect dry States against these shipments from wet States.

Senator LEE. Senator, if your committee votes that way, would your committee and you feel that I was going over your heads, in a way, if I would offer this on the floor?

The CHAIRMAN. We would not. We will have to stand by the bill, that is, I would. I would have to stand by the bill, but there would be no hard feelings if you should offer on the floor of the Senate your proposition. I think it would be very well to have the question discussed.

Senator LEE. It will be delayed too long, I fear, and it won't have any effect if you turn me down.

The CHAIRMAN. Well, I will say this, that Senator King, who is chairman of the subcommittee, has stated that just as soon as we get through with this bill, he will take it up.

Senator LEE. With that understanding, thank you.

Mr. BERKSHIRE. Senator Harrison asked a question which was never answered, and that was on the question of the levying of the tax on the occupation in all of the States alike, and there is a paragraph in the opinion written in the *Constantine case* handed down the year before last by the Supreme Court, which I think is very enlightening. In that case there was imposed the usual tax, the tax that we are talking about, plus another tax which was penal in its provisions, and during prohibition, it was $1,000 in addition to this other tax—the one that we are talking about now. The Court said:

> Third: The repeal of the eighteenth amendment renders it necessary to determine whether the exaction is in fact a tax or a penalty. If it was laid to raise revenue its validity is beyond question notwithstanding the fact that the conduct of the business taxed was in violation of law. The United States has the power to levy excises upon occupations, and to classify them for this purpose; and need look only to the fact of the exercise of the occupation or calling taxed, regardless of whether such exercise is permitted or prohibited by the laws of the United States or by those of a State. The burden of the tax may be imposed alike on the just and the unjust. It would be strange if one carrying on a business the subject of an excise should be able to excuse himself from payment by the plea that in carrying on the business he was violating the law. The rule has always been otherwise. The tax imposed by Revised Statutes 3244 affords an opposite illustration. That act imposes an excise, varying in amount, upon different forms of the liquor traffic. The respondent paid the annual tax of $25 thereby required, despite the fact that he was violating local law in prosecuting his business. Undoubtedly this was a true tax for which he was liable. The question is whether the exaction of $1,000 in addition, by reason solely of his violation of State law, is a tax or a penalty. If, as the court below thought, 701 was part of the enforcing machinery under the amendment, it automatically fell at the moment of repeal.

The CHAIRMAN. Of course, it raises another question. If this committee should attempt to just impose this tax of $25 on persons in States where the law permits liquors to be sold and to prohibit it in other States, would it not violate the principle that the tax laws have to be general in character?

Mr. BERKSHIRE. That is the whole point. If there is any question about that, there are some of our attorneys present who have given that matter a great deal more study than I have.

Senator CONNALLY. Did the court uphold that $1,000 tax?

Mr. BERKSHIRE. No, sir. It held it was unconstitutional and was a penalty.

Senator CONNALLY. That was a tax on dealers under prohibition, was it not?

Mr. BERKSHIRE. In operating in violation of the laws of the State. And the $1,000 which they decided was a penalty was unconstitutional. The one of $25 was not unconstitutional.

Senator HERRING. Because it is a tax?

Mr. BERKSHIRE. Because it is a tax.

Senator HERRING. That is pertinent in this bill.

The CHAIRMAN. We could raise that to $1,025, and the Supreme Court, under what you have just said, would say that it is a revenue matter and in the power of Congress?

Mr. BERKSHIRE. That is right.

Senator HERRING. How can Congress justify imposing a tax upon citizens of a State to an illegal act? I do not see how you can justify it.

Senator CONNALLY. They are not authorizing an illegal act. They are just taxing everybody that sells liquor, whether it is dry or wet.

Senator HERRING. It is against the law to sell liquor, and you say, "We will take $25 from you so that you may do it."

Senator CONNALLY. No; it is not that.

Senator HERRING. Well, they say, "We won't prosecute you."

Senator CONNALLY. It is not a violation of a Federal law. I am in sympathy with Senator Lee's proposal, but it looks to me that it is purely a police matter and not a tax matter. It would be better to let it go through the Judiciary Committee, but I do not regard the Federal Government taxing it has any impediment in the enforcement of the State law. If they can prove that he has a Federal license, it is certainly some presumption that he is violating the State law.

Senator LONERGAN. All of 25 years ago I was in the office of the collector of internal revenue in Hartford, Conn. We had local option. One of the wettest States in the Union—we have 169 towns, and each town votes whether or not it wants a license. It is done every 2 years under petition. Out of the 169 towns, I doubt if we had over 30 or 40 that were wet. The collector of internal revenue sold these permits to residents of all towns, whether they were wet or whether they were dry, and I was surprised at the time, and he explained to me that that was the law, and they assumed no responsibility. So that this is no new feature; it has been the law for a long, long time. And the authorities in each town enforced the law. I do not think there is any new feature here.

Senator KING. We did it in Utah when we were dry.

Senator LONERGAN. The United States Government does not say when we sell you this that "We give you a permit to go out and violate the law." It does not say anything of the kind.

Senator WALSH. Furthermore, when somebody in a dry town was convicted under the State law for violating the intoxicating liquor law, that person immediately ran to the Internal Revenue to get a permit or else he would be charged with violating a Federal law

and have to pay a penalty besides his permit, is that not right, Senator?

Mr. LONERGAN. It certainly would be right now.

Senator WALSH. As soon as a conviction happened in the State court, the Internal Revenue Department would appear and say, "This is a sale of liquor."

Senator LONERGAN. That is right.

Senator WALSH. "And you have no Federal permit to do it; therefore you must pay the penalty now as well as take out the permit."

Senator LONERGAN. Yes.

Senator CONNALLY. You call it a permit. It is not a permit at all. It is just a tax receipt.

The CHAIRMAN. I desire to place in the record the report from the Secretary of the Treasury on Senator Lee's amendment.

MARCH 23, 1938.

Hon. PAT. HARRISON,
Chairman, Senate Finance Committee,
United States Senate.

MY DEAR MR. CHAIRMAN: Reference is made to an amendment which Senator Lee proposes to incorporate in the pending revenue bill to amend section 3 of the Liquor Enforcement Act of 1936. This proposal was transmitted to you by Senator Lee with his letter of March 16, 1938, which you sent to Under Secretary Magill on the same day. Senator Lee's amendment is a revision of S. 3209, introduced by him on January 24, 1938, and now pending before the Senate Judiciary Committee.

An analysis of the bill reveals that it would change section 3 of the Liquor Enforcement Act of 1936 in a number of particulars. Under section 3 in its present form a State is eligible for protection under the act only if all sales therein of intoxicating liquor containing more than 4 percent of alcohol by volume are prohibited, except sales for scientific, sacramental, medicinal, or mechanical purposes. Under that section, such a State will now be given Federal assistance only in the event that it has (a) forbidden all importations of intoxicating liquors or (b) provided by its laws for permits or licenses to accompany liquors being brought into it.

The present standard of State eligibility for Federal protection under the Liquor Enforcement Act of 1936 is State prohibition of all sales of intoxicating liquor containing more than 4 percent of alcohol, except sales for scientific, etc., purposes. Senator Lee's proposed amendment would substitute therefor a more liberal standard which would apply to all States which prohibit all sales of intoxicating liquor, as defined by the laws of such States, except sales for scientific, etc., purposes.

Senator Lee's proposed amendment would also eliminate the requirement of a State permit system for imported liquors. In lieu of this permit system Senator Lee's amendment would, in effect, substitute a presumption that all intoxicating liquor imported into a State, entitled to protection under the Lee amendment, otherwise than in the course of continuous interstate transportation through such State, shall be presumed to have been imported into such State contrary to Federal law, except when consigned to a dealer in intoxicating liquor for scientific, sacramental, medicinal or mechanical purposes. It would also provide that the burden of proof shall be on the claimant or the accused to rebut such presumption.

The purpose of the Liquor Enforcement Act of 1936 as stated in part by the House Judiciary Committee in its report thereon (Rept. No. 1258, 74th Cong.) "is to enforce the twenty-first amendment to the Constitution of the United States, which was delared to be effective on December 5, 1933 and which guarantees Federal protection to 'dry' States against liquor-law violations directed from outside their borders."

Section 3 of that act was subjected to the most searching study by the judiciary committee of both Houses and it was enacted into law because the committees and the Congress felt that the only effective method of extending Federal assistance in the enforcement of the twenty-first amenddment was by adopting a standard which if met by the States would enable them to secure Federal assistance in preventing importations of liquor contrary to their laws.

Senator Lee in his letter to you states: "It is my contention that our State has a prohibition law in spirit and letter and that we are entitled to Federal pro-

tection from the importation of liquor from other States, and in this regard, may I quote the words of President Roosevelt in his speech of acceptance in Chicago in 1932:

"I say to you now that from this date on the eighteenth amendment is doomed. When that happens we as Democrats must and will, rightly and morally *enable the States to protect themselves* against the importation of intoxicating liquor where such importations may violate their State laws."

I have italicized the words "enable the States to protect themselves" because I believe that the enactment of the Liquor Enforcement Act on June 25, 1936, fulfilled that promise and the lack or failure of protection to the States has been due solely to the failure of such States to model their legislation in such fashion as to avail themselves of the protection afforded by Congress. The congressional intent in enacting section 3 is further indicated by the following excerpts from the report of the House Judiciary Committee on the bill which became the Liquor Enforcement Act of 1936 (House Rept. No. 1278, 74th Cong.):

"The determination of whether an offense has been committed (under section 3) turns upon the existence of a State license or permit system, or a complete embargo on all bringing of liquor into the State. In the former case it will be an offense to ship intoxicating liquor unaccompanied by a permit or license into the States; in the latter it will be an offense merely to transport such liquor into the State.

"In the absence of either one of these two control methods it would be exceedingly difficult to make effective administration of a Federal protective system feasible, since the legality of a liquor shipment into a State could be determined only by investigation of the use for which it was intended. The establishment of Federal machinery as elaborate as that of prohibition days would be required in the absence of State cooperation taking the form of one or the other of the control methods devised.

* * * * * * *

"Briefly, the permit system will operate in this fashion: When a 'dry' State permits certain shipments of intoxicating liquor, but has no permit system to cover them, it will receive no Federal protection; when a 'dry' State has a permit system applicable to some shipments into the State, but not to all, it will receive Federal protection only to the extent of its permit requirements; when a 'dry' State has a permit system applicable to all shipments, it will receive full Federal protection."

From a practical standpoint I believe that Senator Lee's amendment would greatly increase the enforcement difficulties which the Government would be likely to encounter. His amendment fails to provide any means for determining whether a shipment of liquor is consigned to a dealer in intoxicating liquor for scientific, sacramental, medicinal, or mechanical purposes. Presumably the amendment contemplates that ordinary shipping documents in common commercial use shall evidence the consignment of the liquors to such a dealer. It is likely that even this evidence would be absent in the case of shipments imported by other than common carrier. Shipping documents are in myriad forms. They issue from multitudinous sources and under no single authority. Experience has shown that illicit traffickers in liquor make free use of false shipping documents. On the other hand, in a comparable situation, under existing law, all importations would require a permit which would issue from a single source of governmental authority, the State itself. Such permits would presumably be of some sort of distinctive paper, serially numbered, on a standard form, and bear other evidence of their authenticity which would make identification easy and forgery difficult. It is evident then that the States have complete control over the authorizations for the lawful introduction of liquors into the State. Thus the States (in the language of the President) under present Federal law, are enabled to protect themselves against the importations of intoxicating liquor.

A further objection to Senator Lee's amendment may be stated. Under the amendment each State is given the authority to define what constitutes "intoxicating liquor" the prohibition of the sale and importation of which will entitle it to Federal protection. Thus, one State might define intoxicating liquor as liquor containing more than 6 percent of alcohol; another State 14 percent; and a third State might define such term as applying to distilled spirits only. Obviously, there could be 48 definitions of intoxicating liquor. Under this analysis, the proposed amendment would be a distinct departure from the purposes for which the Liquor Enforcement Act of 1936 was enacted. It could result in fostering State monopoly in intoxicating liquors, and require Federal protection of States which in every real sense of the word are "wet" States.

As I have stated, the standards laid down by section 3 of the Liquor Enforcement Act in its present form as a prerequisite to Federal protection, were the result of intensive consideration of this problem by the Congress. In view of these circumstances, I suggest that any proposal for a departure from these standards should receive an equally exhaustive examination.

Senator Lee's proposal apparently is predicated upon the influx of tax-paid liquor into the State of Oklahoma. It would seem that the deplorable condition of which he writes is due largely to the inactivity of State officers. Under date of February 21, 1938, Senator Lee addressed a letter to the Attorney General of the United States and sent a copy to me. In it, he quoted a significant paragraph from a letter addressed to him by Charles N. Champion, assistant district attorney, eastern district, Muskogee, Okla. I quote in part from that paragraph:

"For the past several months, I am told, the traffic on the highways leading from Arkansas and Texas into Oklahoma has been congested by the bootleggers in Oklahoma hauling tax-paid whisky into the State for sale. Of course, as you know, the State and county officers are making very little, if any, effort whatever to enforce the State prohibitory laws. The result is, of course, that Oklahoma is practically wet and is receiving no tax whatever from the sale of liquor and all of the tax is going to Arkansas and Texas."

For the foregoing reasons I strongly recommend against the adoption of the proposed amendment.

Very truly yours,

H. MORGENTHAU, Jr.
Secretary of the Treasury.

The CHAIRMAN. We will take this matter up later. Mr. Mehl, the Assistant Chief of the Commodity Exchange Administration of the Department of Agriculture, is here. Some of the members wish to hear him regarding this tax on sales of produce for future delivery.

Senator KING. We had some testimony on that.

The CHAIRMAN. Yes; we have had testimony. The section is on page 343 of the bill. The House has placed it at 1 cent.

Senator KING. Mr. Tumulty made a very able presentation and wrote a very fine brief. Do you agree with that, Mr. Mehl?

STATEMENT OF J. M. MEHL, ASSISTANT CHIEF, COMMODITY EXCHANGE ADMINISTRATION, DEPARTMENT OF AGRICULTURE

Mr. MEHL. Mr. Chairman, the Commodity Exchange Administration has no direct interest in the subject of this tax, and I would, therefore, like to have the record show that I am appearing at the request of the committee and in place of Dr. Duvel, who is absent from the city. I find that Dr. Duvel had expressed his view concerning the tax in a letter which was addressed to the chairman of the Ways and Means Committee of the House under date of February 24. Do you want me to put that in the record?

The CHAIRMAN. Give it to us for the record. Without objection, it will be inserted.

(The following document, by direction of the chairman, was inserted in the record:)

FEBRUARY 24, 1938.

Hon. ROBERT L. DOUGHTON,
Chairman, Ways and Means Committee,
House of Representatives.

DEAR MR. DOUGHTON: Pursuant to a motion made by Mr. Vinson when I was before your committee last Thursday I give the following involving the matter of tax on futures transactions:

Based on my experience of more than 15 years in the administration of the Grain Futures Act and the Commodity Exchange Act, it is my belief that—

(*a*) It would be of value to the commodity markets if this tax could be eliminated entirely. It places a particularly heavy burden on the scalpers who

give flexibility to the market. In fact, without the presence of scalpers a futures market cannot function efficiently in that hedgers desiring to sell a future as a protection against loss would be compelled to sell at a lower price and hedgers desiring to buy a future as a protection against the sale of flour would be compelled to pay a higher price than justified. In the former case the result would be a lower price to producers and in the latter case a higher price to consumers.

(b) If it is deemed essential to provide a tax on futures transactions the tax should not exceed 1 cent per $100 of the value. The present 3-cent tax is excessive and a burden on the market. Moreover, with a rate of tax of 1 cent per $100 made to apply to all sales it is believed that the returns in revenue will be approximately the same as under the present 3-cent tax in that there will result a larger volume of trading and a corresponding increase in the stability and flexibility of the market which will be of value both to producers and consumers.

(c) During the period from May 10, 1934, to the end of December 1937, the tax was 3 cents per $100, which rate of tax is now in effect. During this same period the average price of No. 2 Hard Winter Wheat at Kansas City was $1.095 per bushel, whereas during the 8-year period from July 3, 1924, to June 21, 1932, with a tax of 1 cent per $100 the average price of the same grade of wheat at Kansas City was $1.154. During this first period of approximately 3½ years, involving a tax rate of 3 cents, the average annual volume of trading in all wheat futures at Chicago was 8,404,000,000 bushels, compared with an average annual volume of trading of 11,964,000,000 bushels during the 8-year period involving the 1-cent tax. Comparing these two periods, there was approximately 40 percent more trading during the 8-year period under the 1-cent tax than during the 3½-year period under the 3-cent tax.

It is, of course, not claimed that the higher rate of tax was the cause of the lower average price or of the lower volume of trading. There are so many factors which enter into price and volume of trading that it is impossible to measure cause and effect.

There is transmitted herewith a table showing the volume of trading in all grains on all markets by fiscal years ending June 30 of the years designated. The totals listed in this table include scratch trades, i. e., futures bought and sold on the same day on the same market at the same price for the account of the same person which trades are not taxed under the present law. In the case of grains, scratch trades represent from 25 to 30 percent of the total. The tax applies equally well to futures sales of commodities other than grain, but figures covering the volume of trading for other commodities are not available.

Very truly yours,

J. W. T. DUVEL, *Chief.*

[Enclosure.]

Volume of trading in futures, all grains in all contract markets—for the fiscal year ended June 30

[Thousands of bushels]

1921	23, 808, 434	1930	21, 199, 527
1922	19, 852, 453	1931	13, 530, 875
1923	16, 139, 333	1932	11, 745, 651
1924	20, 403, 545	1933	18, 213, 781
1925	30, 496, 950	1934	13, 963, 833
1926	21, 602, 753	1935	11, 919, 147
1927	19, 720, 662	1936	12, 110, 086
1928	19, 304, 242	1937	16, 672, 281
1929	25, 312, 472		

Mr. MEHL. I will not take time to read the letter. In substance it recommends first the elimination entirely of the tax on future sales of produce on commodity exchanges.

Senator CONNALLY (interposing). Wheat, cotton, and everything?

Mr. MEHL. All commodities that are sold on the commodity exchanges for future delivery. And secondly, the recommendation is

made that if it is not seen fit to eliminate the tax entirely, that it should be reduced to not more than 1 cent per $100 of value instead of the present 3 cents.

I said that the Commodity Exchange Administration has no direct interest in this subject. It does have an indirect interest in that it wishes to see a futures market that will serve most adequately the needs of hedgers and handlers of the actual commodity. To be of value to hedgers, a futures market must be liquid. It must be a readily available market. It must be a market which will absorb instantly fairly large buying and selling orders without price disturbance. Such a market does enable distributors of the actual commodity to operate on a smaller margin of profit, because it enables them to shift the burden of price risk which would otherwise be a part of their cost of handling.

In any broad futures market, like cotton and wheat, there are four groups of traders—hedgers, spreaders, scalpers, and ordinary speculators. I shall not take time to distinguish between those groups except to say that the scalper—and I think that name is unfortunate; I prefer to call them "in and out traders"——

Senator WALSH (interposing). Excuse me for a moment. Is it your position that you are opposed to this tax or willing to have it repealed but that you want some legislation from some other committee of Congress on this subject?

Mr. MEHL. No; we are not seeking any other legislation.

Senator WALSH. Do you expect us in this bill to bring about the remedy that you are suggesting?

Mr. MEHL. Yes; I propose to indicate presently that this tax—and I am viewing it entirely from the standpoint of market utility—imposes a burden upon a special kind of trader only, the one least able to bear it and perform his proper function in the market.

Senator WALSH. Have you an amendment to substitute for this revenue-raising provision?

The CHAIRMAN. The proposal would be to eliminate this tax altogether if his suggestion were carried out, Senator.

Senator KING. He is asking for no legislation, as far as I know, except a recommendation to repeal the tax.

The CHAIRMAN. How much revenue is involved in this tax of 1 cent?

Mr. MAGILL. The yield for the current fiscal year was about $5,000,000; that was at 3 cents. Reducing it to 1 cent would presumably cut that down. You will notice on page 344 of the print there was also a change, I think at the suggestion of Dr. Duvel, that struck out this exemption of so-called scratch sales, and that would have the effect of somewhat increasing the revenue, but we feel the loss would be about $1,000,000.

Senator CONNALLY. Your theory is that a tax in any amount is a deterrent to transactions on the board, and you want to encourage these to have the utmost freedom?

Mr. MEHL. Yes; in that it is a real burden on a special group of traders, the in-and-out traders. They are speculators in a sense, but not in the sense that they play for large profits.

Senator CONNALLY. They are not professional traders, but men that come in now and then?

Mr. MEHL. They are specialists, known as scalpers. They trade on short turns in the market and do not as a rule take even an overnight position. Their interest is in eighths and quarters. The function of the scalper is to absorb a preponderance of selling orders or buying orders until such time as they are taken up by other traders, including hedgers.

The CHAIRMAN. Senator Capper, I may say that Mr. Mehl, who is testifying, is the Assistant Chief of the Commodity Exchange Administration and is talking on the stamp tax on sales of produce for future delivery.

Mr. MEHL. If you will permit me, I would like to discuss for a moment what we consider the function of the so-called scalpers, or in-and-out traders.

I was interested in reading some of the previous testimony, and particularly interested by the suggestion that perhaps this tax was intended to penalize the speculator. I don't know anything about that, but if that were the purpose of the tax, it would fail of that purpose completely, because the big speculator is not interested in eighths and quarters; he is interested in finding a market trend, either up or down, and riding it for profits of 5 or 10 cents a bushel. Obviously, if a man goes in, say, and sells short 100,000 bushels of May wheat futures at $1 a bushel, and a month later buys them back at 90 cents, he has made $10,000, and a tax of 3 cents would be only $30. That is no burden on that type of speculator. And if he could lose $10,000, he could also stand a tax of $30.

But the tax does vitally affect this special group of traders which are commonly referred to as scalpers. The viewpoint of the in-and-out trader is entirely different from that of the general run of speculator. His attention is focused on the minute fluctuations during the day instead of on changes in fundamental conditions. The profits and the losses of the in-and-out trader are measured in terms of eighths and quarters of a cent a bushel.

Senator CONNALLY. Is he of any benefit to the market—that kind of a trader?

Mr. MEHL. Yes. His main contribution to the market by way of cushioning and temporarily holding purchases and sales until they are absorbed by other traders. We know that in the wheat market, for example, on the Chicago Board of Trade—which is the largest futures market in the world—if it were confined to hedging orders, it would be unusual if the orders to sell and the orders to buy would come into the market exactly at the same moment. The scalper who is interested in the eights and the quarters is keen to see when there is a preponderance of selling orders and if there is no change in the market conditions, he is willing at a slight dip in the market to come in and become a buyer, because he knows from common experience that in a few minutes, or even in seconds, there will be another order on the other side. I think the scalper is responsible for stepping down into graduations of eights and quarters what otherwise would be larger price fluctuations during the day.

Senator KING. Does your organization, after long experience and investigation, reach the conclusion that it is beneficial to the producer of wheat and grain and what not to permit these transactions on the exchange? Does it facilitate sales and does it depress or does it augment the prices?

Mr. MEHL. Under the present system of marketing—and I do not feel that I should become a defender or a condemner of the present system, because the policy of Congress has, for the time being at least, been written into the Commodity Exchange Act. It recognizes futures trading as a valid and a proper kind of insurance, and there is no question that in the present system of marketing—I am not saying that there cannot be a better system—the hedging facilities provided enable handlers and distributors to move grains and cotton from the farm to the ultimate consumers at a smaller cost per unit than they otherwise could.

Senator CONNALLY. Your theory is that it is a sort of insurance?

Mr. MEHL. Yes.

Senator CONNALLY. In other words, if I buy and I know that I can hedge against it, I will be more apt to do it. I do not want to interrupt the witness, but I move that we eliminate it entirely.

The CHAIRMAN. You had some questions to ask, Senator Capper? There was a representative from your State here who opposed the removal of this tax. That is why I am calling it to your attention.

Senator CAPPER. Is not the weakness of this system that the producer, the farmer, has nothing to say about this market? And it means more to him than anybody else. He has no part in the set-up of the market.

Mr. MEHL. Excepting as through his cooperative associations he may participate in the exchange.

Senator CAPPER. Yes, they can. They had a long hard fight to get that.

Mr. MEHL. And our law—the Commodity Exchange Act—gives them the privilege of representation on the exchanges.

Senator CAPPER. But that is only a small part of the volume of trading done by the farmer.

Mr. MEHL. That is correct.

Senator CAPPER. Which tax will bring in the most money for the Government—the present tax in force or this new tax set up in this bill?

The CHAIRMAN. The House reduced it to 1 cent, as you recall, and then put in scratch sales also.

Senator CAPPER. I would like to know what is the net result of that? Whether that will bring in more money to the Government than comes in under the present law?

Senator WALSH. If we wiped out the House provision, the testimony is that we lose $5,000,000.

Mr. MAGILL. If you strike the House provision out you lose about $5,000,000.

Senator CAPPER. Then the bill as it comes from the House is a better plan than the present law?

Senator CONNALLY. According to the testimony, it is recommended that the entire tax be eliminated.

The CHAIRMAN. The theory is that it would be better if the whole proposition were stricken out.

Senator CAPPER. I would like to have a comparison of the net result of the present law and the plan that is embodied in this bill. Which will bring in the most money?

Mr. MAGILL. Senator Capper, the present law yields about $5,000,000, and we estimate we will get about $1,000,000 less under the House

provision. In other words, it represents a net reduction altogether of about $1,000,000.

Senator CAPPER. So it is an advantage to the Chicago Board of Trade?

Mr. MAGILL. We contemplate that we would get that much less money from the new provision.

(At this point further report of the proceedings was discontinued.)