EXCESS PROFITS TAXES OF COMMERCIAL BANKS[1]

In December 1951, the Federal Reserve Banks transmitted a confidential tax questionnaire to a selected sample of insured commercial banks.[2] One of the purposes of the questionnaire, which was prepared by the Board of Governors of the Federal Reserve System with the cooperation of other Federal agencies, State bank supervisory agencies, and bankers' associations, was to collect factual data bearing on the effect of taxation on the ability of banks to improve their capital positions out of earnings and to attract new capital. The cooperation of the selected banks in responding to the questionnaire was generous, particularly in view of the complexity of the subject matter and the fact that the work had to be done about the time that banks were preparing their regular year-end reports.

The phase of the problem that was of immediate interest—and for which data were not then available—was the effect of the newly reinstituted excess profits tax. This article presents data, derived from the replies to the questionnaire, relative to the amounts of excess profits taxes on bank earnings and the extent to which they affect the ability of banks to strengthen their capital positions. Such an approach requires primarily relating excess profits taxes to capital. The impact of other Federal corporate taxes is covered incidentally and in less detail.

The statistics presented show the impact of excess profits taxes on the commercial banking system as a whole, with subgroupings of banks by size and capital ratios. Effects on policies and operations of individual banks (or other corporate taxpayers) subject to the tax, whose additional income may thereby be subject to a normal and surtax rate of 52 per cent and an excess profits tax rate of 30 per cent, cannot of course be measured on the basis of these statistics alone.[3]

Sources of bank capital. Although for many years retained earnings have been the principal source of additions to bank capital accounts, in 1950 and 1951 sales of new stock provided a substantial proportion of additional capital. Taxes, like other factors that decrease net profits, reduce the amount available for dividends or retention in capital accounts. As background for a general measure of the effect of taxes on retained earnings and bank capital, Table 1 compares aggregate member bank dividends, changes in capital accounts, and Federal income and excess profits taxes for the period 1948-51.

TABLE 1

DIVIDENDS, INCREASES IN CAPITAL ACCOUNTS, AND FEDERAL INCOME AND EXCESS PROFITS TAXES OF ALL MEMBER BANKS, 1948–51

[In millions of dollars]

Year	Cash dividends on common stock	Changes in total capital accounts				Federal taxes	
		Net change	Retained earnings	Sales of common stock [1]	Other[2]	Normal and surtax [3]	Excess profits tax
1948	290	+337	+327	+44	−34	219	......
1949	309	+373	+373	+37	−37	257	......
1950	343	+521	+435	+130	−44	[4] 335	[4] 12
1951	368	+524	+385	+186	−47	[4] 445	[4] 20

[1] Not available for nonmember banks, or for member banks prior to 1948. Available data for national banks indicate that retained earnings accounted for the great bulk of increases in capital accounts for many years before 1948.

[2] Net decreases resulting from miscellaneous factors affecting capital accounts of member banks, such as consolidations and mergers, retirements of preferred stock, and changes in Federal Reserve membership.

[3] On the basis of data reported to bank supervisory agencies in official reports of earnings and dividends.

[4] Estimate. For all insured commercial banks estimated excess profits taxes were 15 million dollars in 1950 and 24 million in 1951.

[1] The study of excess profits taxes of commercial banks here reported was under the direction of a Federal Reserve System advisory subcommittee representing the Board and the Reserve Banks. The present article was prepared by Raymond C. Kolb of the Board's Division of Bank Operations.

[2] See Appendix for brief discussion of sample technique, accuracy of results obtained from sample, etc. Data in this article are estimates based on the sample; they differ somewhat from other published data on bank earnings, but not enough to affect the discussion materially. In particular, data on taxes used herein, although comparable to tax items normally reported in official earnings and dividend reports, are the amounts applicable to income for 1950 and 1951; tax data normally reported to and published by the supervisory authorities, on the other hand, apply to the current year for banks operating under a tax accrual accounting system but to the preceding year for banks operating on a cash basis.

[3] Current law limits the excess profits tax to 18 per cent of excess profits net income before deduction of excess profits credit; the 30 per cent rate is applied to *adjusted* excess profits net income, which is excess profits net income less excess profits credit. For discussion of the principal methods for determining excess profits credit, see pp. 608-09 of this article. See also *Annual Report of the Secretary of the Treasury on the State of the Finances,* fiscal year ended June 30, 1951, pp. 47-51.

The two principal sources of bank capital are closely related. Retained earnings are affected directly by net profits and dividends; and the willingness of investors to subscribe to new stock issues is affected by dividend payments and retained earnings. In a given profits situation, bank management interested in improving its capital position has to weigh the relative improvement that might be attained by plowing back earnings as against a dividend policy which would tend to make a favorable market for new stock issues. The determinants in arriving at such decisions vary from bank to bank. As Table 1 shows, the aggregate effect of individual bank policies during the past two years has been for sales of common stock to account for a substantial proportion of capital additions. Nevertheless, retention of earnings has been, and still is, the principal source of additions to bank capital.

Capital ratios. Despite substantial increases in bank capital accounts, for years capital ratios have declined almost steadily because of the much faster growth of bank assets. As shown in Table 2, although total capital accounts of insured commercial banks increased from 6.2 billion dollars in December 1935 to 11.9 billion in 1951, the ratio of capital accounts to total assets declined from 12.2 to 6.7 per cent, and the ratio of total capital accounts to so-called "risk assets" (total assets less cash assets and United States Government securities) declined from 26.1 to 16.4 per cent.

TABLE 2

CAPITAL RATIOS OF ALL INSURED COMMERCIAL BANKS DECEMBER 31, 1935 AND 1948–51

[Dollar amounts in millions]

Year	Total capital accounts	Total assets	"Risk assets" [1]	Percentage ratio of total capital accounts to:	
				Total assets	"Risk assets"
1935	$6,210	$50,918	$23,792	12.2	26.1
1948	10,160	152,163	52,659	6.7	19.3
1949	10,649	155,319	54,250	6.9	19.6
1950	11,281	166,792	65,881	6.8	17.1
1951	11,923	177,449	72,608	6.7	16.4

[1] Total assets less cash assets and U. S. Government securities.

Concepts of capital. Banking institutions are inclined to be conservative in stating the book value of capital accounts in their published statements. In official condition reports submitted to banking authorities, likewise, bank assets are reported net of reserves for bad debts, other valuation reserves, and charge-offs; these charges, of course, are made against capital accounts. It is this book-value measure of capital that has been used in the foregoing discussions of bank capital and capital ratios.

Data reported in the confidential tax questionnaire permit statistical treatment of capital according to a somewhat different concept—that of equity invested capital. Equity invested capital is the concept of capital used for excess profits tax purposes. It differs from book capital primarily because the latter excludes (1) valuation reserves for possible losses on loans and securities, and (2) write-downs of loans, securities, and real estate not recognized by the Bureau of Internal Revenue as deductible expenses for excess profits tax purposes.

For the commercial banking system as a whole, equity invested capital is about 10 per cent higher than book capital.[4] As shown in Supplementary Table 1 on page 611, the reported difference between book and equity capital varies among size groups of banks; it varies much more among individual banks. Presumably the variation reflects for the most part widely different amounts of nonbook capital. To some extent, however, it reflects differences in accounting methods (cash versus accrual) for tax and book purposes; the fact that book capital in the table is as of the year-end whereas equity invested capital is as of the beginning of the year plus the daily average of new capital during the year; and possibly the failure of some banks to report all nonbook capital in their tax questionnaires.

Both of the concepts described above are used in the remainder of the article. The book value of capital accounts (referred to as "total capital accounts") is used for classifying banks by the dollar size of capital and for computing relationships of capital to assets for the banking system. However, because of the variation among individual banks in the differences between book capital accounts and equity invested capital, the equity invested capital concept (referred to as "equity capital") has been used for the purpose of grouping individual banks by ratios of capital to assets and for

[4] It is estimated that about one-fourth of this difference is attributable to the use of the "historical" invested capital credit method (see text and footnote 11, p. 609) by a relatively few large banks. Under this method, the amount of capital historically contributed to the business may exceed the net book value of assets principally by reason of assigning zero values to accumulated deficits, including those of transferor corporations.

computing rates of earnings, taxes, and dividends on capital in Supplementary Table 2 on page 612.

Excess profits taxes on taxable income. About 25 per cent of the insured commercial banks incurred total excess profits taxes of about 15 million dollars on 1950 income, and about 21 per cent of the banks incurred about 24 million of such taxes on 1951 income, as shown in Table 3.[5] Other Federal corporate income taxes on banks aggregated 408 million dollars on 1950 income and 542 million on 1951 income, as shown in Supplementary Table 1 on page 611.

By comparing reported data on excess profits net income with available excess profits tax credits, it is estimated that, as a maximum, an additional 13 per cent of insured commercial banks would become subject to excess profits taxes in some amount if taxable income were to increase by 10 per cent. This maximum would not be reached because of increases in capital or borrowings and consequent increases in banks' excess profits credits.

Excess profits taxes were incurred in varying degrees by banks in the four selected size groups shown in Table 3. However, a somewhat larger proportion of banks in the two intermediate-size groups combined than in either the group of small or large banks was in the excess profits tax bracket; this was true also with respect to capital accounts. So far as the largest banks as a group are concerned, somewhat larger equity capital in relation to total assets provided a more advantageous base for computing the excess profits credit under the invested capital method; and there is evidence of more extensive use of some of the tax-saving provisions of the law, especially in 1951, to minimize the tax burden.[6] The minimum credit of $25,000 permitted by law obviated payment of excess profits taxes by most of the small banks.

For all insured commercial banks, as shown in Supplementary Table 1, excess profits taxes incurred on 1951 income were 0.2 per cent of end-of-year total capital accounts. In comparison, other Federal corporate income taxes were 4.6 per cent and earnings retained were 3.9 per cent of year-end total capital accounts.

If all of the 1951 excess profits taxes could have been retained in total capital accounts, the year-end ratio of total capital accounts to total assets for all insured commercial banks could have been increased from about 6.81 to 6.83 per cent. Earnings retained by insured commercial banks during 1951 served to raise the capital-to-assets ratio to 6.81 per cent; without such retained earnings the ratio would have been 6.55 per cent.

For the banks that incurred excess profits taxes on 1951 taxable income, the addition to total capital accounts of an amount equal to their excess profits taxes would have increased the year-end ratio of total capital accounts to total assets from 6.04 to 6.08 per cent. Similar computations for individual banks would, of course, show considerable variation in results, as indicated on pages 607-08. These data provide quantitative indications of the effect of excess profits taxation in 1951 on the ability of the commercial banking system as a whole and of the banks that incurred excess

[5] For most banks as well as other taxpayers (those with fiscal years corresponding with calendar years), excess profits taxes were applicable to only one-half of 1950 income due to the July 1, 1950 effective date of the legislation.

[6] Most large banks used the invested capital method. See pp. 608-09.

TABLE 3

EXCESS PROFITS TAXES INCURRED BY INSURED COMMERCIAL BANKS ON TAXABLE INCOME, BY SIZE OF BANK, 1950 AND 1951

Size of bank (Total capital accounts, June 30, 1951)	All insured commercial banks		Banks incurring excess profits taxes					
	Number	Total capital accounts (In thousands of dollars) [1]	Number as percentage of all banks in group		Total capital accounts as percentage of group total		Amount of excess profits taxes (In thousands of dollars)	
			1950	1951	1950	1951	1950	1951
$4,000,000 and over	[2] 284	6,800,000	35	33	25	30	7,600	9,400
$750,000–$3,999,999	1,384	2,200,000	33	30	33	30	3,200	6,200
$250,000–$749,999	3,877	1,700,000	41	37	41	37	3,200	6,000
Under $250,000	7,868	1,000,000	16	12	23	17	900	1,900
Total	[2] 13,413	11,700,000	25	21	28	30	14,900	23,500

[1] As of Dec. 31, 1951.
[2] See footnote 1 to Supplementary Table 1, p. 611.

profits taxes to improve capital positions out of retained earnings and profits.[7]

Taxes allocated to current earnings. The foregoing discussion has been concerned with taxes incurred on taxable income, that is, on net current earnings, capital gains, recoveries, etc., less bad debts, losses incurred on sales of bonds, etc. Essentially, bank income can be considered as falling into two categories. First, there are the net current operating earnings, representing income derived and expenses incurred in the normal course of banking business, such as extension of bank credit through loans and investments, receipt of deposits, cashing and collection of checks, trust operations, etc. Second, in the performance of these functions, bad debts are written off, recoveries are made, profits or losses are realized on securities bought and sold, and so on. These transactions take place every year; however, the dollar amounts fluctuate widely, sometimes adding to net current earnings and sometimes reducing them. In the eyes of many investors, the appropriate measure of a bank's income is its net current operating earnings position after applicable taxes.[8]

[7] The effect of excess profits taxes on the ability of individual banks to improve their capital positions by selling new stock cannot, of course, be measured on the basis of over-all statistics, since many factors other than excess profits taxes may affect the market for a new stock issue.

[8] In 1951, deductions from net current earnings on account of noncurrent transactions amounted to approximately 200 million dollars, compared with 120 million for 1950; a substantial portion of the 1951 deduction was due to the establishment of losses, deductible for tax purposes, on sales of securities. Some banks make a practice of trading in securities as a part of their normal current operations. Bank earnings report forms do not, however, require that a distinction be made between current and noncurrent gains and losses on purchases and sales of securities.

Data in the confidential tax questionnaire make available for the first time an allocation of taxes as between those applicable to current operations and those applicable to noncurrent transactions. The accompanying tabulation reconciles the estimated amounts of Federal taxes incurred by insured commercial banks on 1951 taxable income, as discussed above, with the amounts allocated to current operations:

	Normal and surtax	Excess profits tax
	(In millions of dollars)	
Taxes allocated to net current earnings	639	44
Less tax reduction resulting from noncurrent losses, etc.	97	20
Taxes incurred on taxable income	542	24

It will be noted that taxes allocated to current earnings were considerably higher than the amounts actually incurred on taxable income. In the case of excess profits taxes, the amount allocated to current earnings was 44 million dollars for 1951, compared with 24 million actually incurred. The 44 million dollar figure was equal to 0.37 per cent of year-end total capital accounts.

If taxes had been based only on current earnings, all size groups of banks except the smallest would have shown an increased proportion of both banks and capital accounts in the excess profits tax bracket. This is indicated by the comparative data for 1951 shown in Table 4.

It will be noted that about 8 per cent more of the largest banks and 7 per cent more of the intermediate-size banks would have paid excess profits taxes if there had been no noncurrent offsets to cur-

TABLE 4

COMPARISON OF EXCESS PROFITS TAXES ON 1951 TAXABLE INCOME OF INSURED COMMERCIAL BANKS WITH EXCESS PROFITS TAXES ALLOCATED TO 1951 CURRENT EARNINGS, BY SIZE OF BANK

Size of bank (Total capital accounts, June 30, 1951)	Banks incurring excess profits taxes on taxable income			Banks reporting excess profits taxes allocated to current earnings		
	Number as percentage of all banks in group	Total capital accounts as percentage of group total	Excess profits taxes incurred (In thousands of dollars)	Number as percentage of all banks in group	Total capital accounts as percentage of group total	Excess profits taxes allocated to current earnings (In thousands of dollars)
$4,000,000 and over	33	30	9,400	41	43	23,000
$750,000–$3,999,999	30	30	6,200	38	36	10,000
$250,000–$749,999	37	37	6,000	43	42	8,500
Under $250,000	12	17	1,900	12	17	2,500
Total	21	30	23,500	24	39	44,000

TABLE 5

ESTIMATED AMOUNTS OF EXCESS PROFITS TAXES INCURRED BY INSURED COMMERCIAL BANKS ON 1951 TAXABLE INCOME BY SIZE OF BANK AND BY "LOW-CAPITAL" AND "OTHER" GROUPS[1]

Size of bank (Total capital accounts, June 30, 1951) and capital position	Number of banks		Total capital accounts		Excess profits taxes on taxable income (In thousands of dollars)
	All insured commercial banks	Percentage reporting excess profits taxes on taxable income	All insured commercial banks (In thousands of dollars)	Percentage held by banks reporting excess profits taxes on taxable income	
Banks in all size groups:[2]					
"Low-capital" banks	3,414	28	3,300,000	50	12,500
Other banks	9,999	19	8,400,000	22	11,000
Banks with capital accounts of $4,000,000 and over:[2]					
"Low-capital" banks	73	55	2,100,000	54	6,000
Other banks	211	25	4,700,000	19	3,400
Banks with capital accounts of $750,000 to $3,999,999:					
"Low-capital" banks	358	44	600,000	48	3,000
Other banks	1,026	25	1,600,000	23	3,200
Banks with capital accounts of $250,000 to $749,999:					
"Low-capital" banks	1,009	49	400,000	49	2,700
Other banks	2,868	33	1,300,000	33	3,300
Banks with capital accounts of less than $250,000:					
"Low-capital" banks	1,974	13	200,000	19	800
Other banks	5,894	11	800,000	16	1,100

[1] "Low-capital" banks are the one-fourth of the banks with the lowest ratios when arrayed in the order of their ratios of equity capital to total assets. In order to gain representativeness over the wide range of bank sizes comprehended in the group of banks with total capital accounts of 4 million dollars or more—up to total capital accounts in excess of 400 million—this group of banks was divided into four subgroups (total capital accounts 4–8 million dollars, 8–25 million, 25–100 million, and more than 100 million) and the lowest one-fourth of the banks in each subgroup was combined as the lowest one-fourth for the group as a whole. When more than one bank fell at the quartile ratio, all banks with this ratio were included as below the quartile point; this accounts for the fact that the number of "low-capital" banks is not exactly one-fourth of all banks in each group.

[2] See footnote 1 to Supplementary Table 1 on p. 611.

rent earnings. Noncurrent transactions did not affect to any appreciable extent the number of the small banks that incurred excess profits taxes. So far as amounts are concerned, noncurrent transactions reduced the excess profits tax liability (on current earnings) of large banks more than one-half, of intermediate-size banks about one-third, and of small banks about one-fourth.

Capital ratios and excess profits taxes. A bank's earnings come for the most part from the investment of its deposits and only to a small extent from the investment of its capital. Consequently, a bank with relatively low capital will ordinarily have relatively high earnings in relation to such capital. As might be expected, therefore, it was generally true for all sizes of banks that, the lower the equity-capital-to-total-assets ratio, the more frequently were excess profits taxes incurred and the higher was the tax in relation to equity capital. This is true whether measured by excess profits taxes actually incurred on taxable income or excess profits taxes allocated to current earnings. Supplementary Table 2 on page 612 shows in some detail the average ratios to equity capital of excess profits taxes, profits and earnings after taxes, dividends, and retained profits and earnings, arranged by size of bank and equity capital ratios.

Since a major purpose of the study is to examine the effect of excess profits taxes on the ability of banks to strengthen their capital positions, an analysis has been made of banks with relatively low capital ratios. In Table 5, "low-capital" banks are the one-fourth of the banks with the lowest ratios when arrayed in the order of equity-capital-to-total-assets ratios. As is shown in the table, or as may be computed therefrom:

(1) The one-fourth of the banks with the lowest capital ratios accounted for somewhat more than one-half of the excess profits taxes on 1951 taxable income.

(2) For *all* "low-capital" banks (those incurring as well as those not incurring excess profits taxes), excess profits taxes on taxable income were about 0.38 per cent of year-end total capital accounts, as compared with 0.13 per cent for all other banks.

(3) For the "low-capital" banks *incurring excess profits taxes on taxable income,* the amounts of such taxes were 0.76 per cent of year-end total

TABLE 6

ESTIMATED AMOUNTS OF EXCESS PROFITS TAXES ALLOCATED TO 1951 CURRENT EARNINGS OF INSURED COMMERCIAL BANKS BY SIZE OF BANK AND BY "LOW-CAPITAL" AND "OTHER" GROUPS [1]

Size of bank (Total capital accounts, June 30, 1951) and capital position	Number of banks		Total capital accounts		Excess profits taxes allocated to current earnings (In thousands of dollars)
	All insured commercial banks	Percentage reporting excess profits taxes allocated to current earnings	All insured commercial banks (In thousands of dollars)	Percentage held by banks reporting excess profits taxes allocated to current earnings	
Banks in all size groups: [2]					
"Low-capital" banks	3,414	32	3,300,000	71	23,800
Other banks	9,999	22	8,400,000	26	20,200
Banks with capital accounts of $4,000,000 and over: [2]					
"Low-capital" banks	73	71	2,100,000	83	14,000
Other banks	211	31	4,700,000	24	9,000
Banks with capital accounts of $750,000 to $3,999,999:					
"Low-capital" banks	358	57	600,000	60	5,000
Other banks	1,026	31	1,600,000	28	5,000
Banks with capital accounts of $250,000 to $749,999:					
"Low-capital" banks	1,009	55	400,000	56	3,600
Other banks	2,868	38	1,300,000	37	4,900
Banks with capital accounts of less than $250,000:					
"Low-capital" banks	1,974	14	200,000	22	1,200
Other banks	5,894	11	800,000	16	1,300

[1] See footnote 1 to Table 5.
[2] See footnote 1 to Supplementary Table 1 on p. 611.

capital accounts, as compared with 0.60 per cent for all other banks that incurred the tax.

(4) Of the 3,400 "low-capital" banks, about 28 per cent incurred excess profits taxes on taxable income; about 19 per cent of all other banks incurred such taxes.

(5) The "low-capital" banks that incurred excess profits taxes on taxable income held about 50 per cent of the total capital accounts of all "low-capital" banks; the comparable percentage for other banks was about 22.

Similar comparisons of "low-capital" with other banks on the basis of excess profits taxes *allocated to current earnings* are shown or may be computed from the data in Table 6.

To point up further such differences in the impact of excess profits taxes on taxable income, a comparison has been made in Table 7 between

TABLE 7

ESTIMATED NUMBER OF "LOWEST-CAPITAL" AND "HIGHEST-CAPITAL" [1] INSURED COMMERCIAL BANKS GROUPED BY PERCENTAGE POINT IMPROVEMENTS IN 1951 TOTAL-CAPITAL-ACCOUNTS-TO-TOTAL-ASSETS RATIOS IF 1951 EXCESS PROFITS TAXES ON TAXABLE INCOME HAD BEEN ADDED TO CAPITAL

Approximate improvement in 1951 capital-to-assets ratio (Percentage points)	Number of banks with total capital accounts on June 30, 1951 of:							
	$4,000,000 and over		$750,000–$3,999,999		$250,000–$749,999		Under $250,000	
	"Lowest-capital" banks	"Highest-capital" banks	"Lowest-capital" banks	"Highest-capital" banks	"Lowest-capital" banks	"Highest-capital" banks	"Lowest-capital" banks	"Highest-capital" banks
No improvement [2]	16	28	74	127	209	370	733	761
.001–.010	3	....	13		....			
.011–.050	4	....	20		123			
.051–.100	4	....	20	*10	25	*24	*56	*28
.101–.200	1	....	7		25			
Over .200	....	....	3		12			
Total	28	28	137	137	394	394	789	789

[1] "Lowest-capital" banks are defined as the one-tenth of all insured commercial banks in each size group with the lowest ratios of equity capital to total assets. "Highest-capital" banks are defined as the one-tenth with the highest such ratios. In order to gain representativeness over the wide range of bank sizes comprehended in the group of banks with total capital accounts of 4 million dollars or more—up to total capital accounts in excess of 400 million dollars—this group of banks was divided into four subgroups (total capital accounts 4–8 million dollars, 8–25 million, 25–100 million, and more than 100 million) and the lowest and highest one-tenth of the banks in each subgroup were combined as the lowest and highest one-tenth for the group as a whole.
[2] That is, no excess profits taxes on taxable income.
* Insufficient observations to provide significant distribution.

the one-tenth of the banks with the lowest ratios and the one-tenth with the highest ratios, when banks are arrayed by equity-capital-to-total-assets ratios.[9] The banks shown in the table as having possible improvements in 1951 capital-to-assets ratios are those that incurred excess profits taxes on 1951 taxable income.

(1) About 23 per cent of the "lowest-capital" banks incurred excess profits taxes on 1951 taxable income, and about 5 per cent of the "highest-capital" banks; the amounts of excess profits taxes involved were about 4.5 million dollars and one-third of a million for the two groups, respectively.

(2) Addition to capital of the amount of excess profits taxes incurred on taxable income would have raised the aggregate year-end total-capital-accounts-to-total-assets ratio for the 316 "lowest-capital" banks that incurred the tax from 4.18 to 4.23 per cent. A distribution of the number of banks incurring excess profits taxes by possible improvements in capital ratios as thus computed is shown in the table.

(3) By size of bank, the percentages of "lowest-capital" banks incurring excess profits taxes on taxable income were about 43 for the large banks, 47 for intermediate-size banks, and 7 for the smallest banks. On the other hand, none of the large "highest-capital" banks incurred the tax and only relatively few of the intermediate and small sizes.

Comparison of "lowest-capital" and "highest-capital" banks on the basis of excess profits taxes *allocated to current earnings* shows similar results, as may be seen from Table 8.

Method for determining excess profits credit. For banks, as for most other corporations, there are two principal methods of determining the amount of excess profits credit. These are the "income" and "invested capital" credit methods. The credit computed under the selected method, together with any available unused credits from other years, is deducted from excess profits net income in arriving at the amount subject to tax. There is also a provision that each corporate taxpayer shall be permitted an excess profits credit of not less than $25,000.

Without considering the more complicated details, the "income" method provides a credit equal to a percentage (84 per cent in 1951 and 83 per cent beginning with 1952) of average earnings, before normal tax and surtax, in the best three of the four base period years 1946-49, plus credit for in-

[9] These two groups of banks will be referred to as "lowest-capital," defined as the one-tenth of all insured commercial banks in each size group with the lowest ratios of equity capital to total assets; and "highest-capital," defined as the one-tenth of the banks with the highest such ratios. The median capital ratio for the first group is around 4.5 per cent, and for the other group around 12 per cent.

TABLE 8

ESTIMATED NUMBER OF "LOWEST-CAPITAL" AND "HIGHEST-CAPITAL"[1] INSURED COMMERCIAL BANKS GROUPED BY PERCENTAGE POINT IMPROVEMENTS IN 1951 TOTAL-CAPITAL-ACCOUNTS-TO-TOTAL-ASSETS RATIOS IF 1951 EXCESS PROFITS TAXES ALLOCATED TO CURRENT EARNINGS HAD BEEN ADDED TO CAPITAL

Approximate improvement in 1951 capital-to-assets ratio (Percentage points)	Number of banks with total capital accounts on June 30, 1951 of:							
	$4,000,000 and over		$750,000–$3,999,999		$250,000–$749,999		Under $250,000	
	"Lowest-capital" banks	"Highest-capital" banks	"Lowest-capital" banks	"Highest-capital" banks	"Lowest-capital" banks	"Highest-capital" banks	"Lowest-capital" banks	"Highest-capital" banks
No improvement[2]	8	27	54	127	184	357	733	761
.001–.010	1	....	10		....			
.011–.050	10	....	23		111			
.051–.100	6	1	34	*10	62	*37	*56	*28
.101–.200	3	....	13		25			
Over .200	....	....	3		12			
Total	28	28	137	137	394	394	789	789
Median equity-capital-to-total-assets ratio of banks in group (per cent)	4.7	13.1	4.0	13.4	4.2	13.3	4.5	11.2

[1] See footnote 1 to Table 7.
[2] That is, no excess profits taxes allocated to current earnings.
* Insufficient observations to provide significant distribution.

TABLE 9

PERCENTAGE OF INSURED COMMERCIAL BANKS UTILIZING SPECIFIED METHODS FOR DETERMINING 1951 EXCESS PROFITS TAX CREDIT, BY SIZE OF BANK

Excess profits credit method	Banks with total capital accounts on June 30, 1951 of: $4,000,000 and over	$750,000 to $3,999,999	$250,000 to $749,999	Under $250,000
Banks paying excess profits tax on 1951 taxable income:				
Minimum			5	(1)
Income [2]	20	50	50	(1)
Invested capital [3]	80	50	45	(1)
	100	100	100	100
Banks not paying excess profits tax on 1951 taxable income:				
Minimum		1	18	92
Income [2]	8	13	25	6
Invested capital [3]	92	86	57	2
	100	100	100	100

[1] The number of banks in this category is too small for computing a reliable percentage.
[2] Includes the alternative "growth" and "industry rate of return" methods which are relatively unimportant except in special cases.
[3] Comprises both the "asset" and "historical" methods for determining equity invested capital. The "historical" method is relatively unimportant except in special cases.

creases in capital during the base period and the taxable years.[10]

The "invested capital" method provides for a credit equal to a percentage, before normal and surtax, of invested capital (including three-fourths of borrowed capital) at the end of the base period (12 per cent on the first 5 million dollars of capital, 10 per cent on the next 5 million, and 8 per cent on capital over 10 million).[11]

Under both the "income" and "invested capital" methods, credit at 12 per cent is in general also given for new capital contributed and three-fourths of the average daily increase in borrowings during the taxable years.

The largest banks almost universally used the invested capital method, as indicated in Table 9. The medium-size banks that had to pay the tax were fairly evenly divided between the income method and the invested capital method, while most of those not paying the tax used the invested capital method. The smallest banks used the minimum credit method.

Preliminary data tabulated by the Treasury Department from 1950 tax returns show that, in general, banks and other financial industry groups used primarily the invested capital method for determining excess profits tax credits. In contrast, most large nonfinancial industry groups utilized primarily the income method.

Inadmissible assets. Under the excess profits tax law, assets are termed "inadmissible assets" if income derived from them is exempted from the tax. For practical purposes, they consist of the following three principal categories of bank assets: United States Government obligations fully or partially tax-exempt; obligations of States and political subdivisions; and corporate stocks (with some exceptions).

Since banks are large holders of such assets, the provisions of the excess profits tax law regarding this type of asset are of particular interest. Without going into details, income from inadmissible assets is excluded from income, both in determining excess profits credit under the "income" method and in determining excess profits net income for the taxable year. Under the "invested capital" method, the computed credit is reduced by the proportion that inadmissible assets are of total assets.[12]

Under the "income" method, then, declines in income from inadmissible assets during the base

[10] The "growth" and "industry rate of return" methods are alternative "income" methods, and are relatively unimportant except in special cases.

[11] There are two methods—"asset" and "historical"—for determining the amount of equity invested capital. The "historical" method is relatively unimportant except in special cases.

[12] So far as taxable year capital additions are concerned, a provision regarding "inadmissible assets" contained in the Revenue Act of 1951 provides that if the increase in the total assets of a bank is greater than the increase in its capital during the taxable year, the net capital addition is reduced only by a percentage based on the ratio of *additional* "inadmissible assets" to *additional* total assets acquired since the beginning of its first excess profits tax year. A similar ratio principle applies in the case of the "inadmissible asset" adjustment in determining base period capital additions.

TABLE 10

ESTIMATED HOLDINGS OF AND INCOME FROM INADMISSIBLE ASSETS, ALL INSURED COMMERCIAL BANKS, 1946–51 [1]

[In millions of dollars]

	Total assets	Holdings of inadmissible assets				Net current operating earnings (Before income taxes)	Income from inadmissible assets
		Total	U. S. Gov't wholly and partially tax-exempt obligations	Obligations of States and political subdivisions	Corporate stocks		
1946	144,700	17,800	13,300	4,200	300	1,070	320
1947	150,000	18,000	12,600	5,100	300	1,090	330
1948	149,400	16,600	10,900	5,400	300	1,210	310
1949	154,000	16,500	9,900	6,300	330	1,310	320
1950	165,200	17,500	9,200	7,900	340	1,470	320
1951	172,400	16,000	6,700	8,900	350	1,650	300

[1] See footnote 1 to Supplementary Table 1 on p. 611.
[2] Total assets and holdings of inadmissible assets are as of the year end; income is for the calendar year.

period tend to increase the excess profits credit; and declines since the base period tend to increase taxable income (assuming income from inadmissible assets was replaced by income from other assets).

Under the "invested capital" method, declines in holdings of inadmissible assets as a proportion of total assets during recent taxable years would increase the excess profits credit but (assuming inadmissible assets were replaced by other earning assets) taxable income would also be increased.

The changes that have taken place in aggregate insured commercial bank holdings of, and income from, inadmissible assets since 1946, the first base period year, are shown in Table 10. Such changes for individual banks show wide variations around the trends indicated by the aggregate data. The several provisions of the excess profits tax law regarding inadmissible assets are such that the matter of appropriate inadmissible assets policy is an individual bank problem.

As a result principally of the maturity or retirement of wholly and partially tax-exempt United States Government securities, bank holdings of such securities declined by about 6.5 billion dollars from 1946 to 1951. Of this decline, however, about 4.5 billion was offset by increased holdings of obligations of States and political subdivisions. The ratio of inadmissible asset holdings to total assets, accompanying substantial increases in total assets over the period, declined from about 12.3 to 9.3 per cent.

Aggregate income from inadmissible assets has not changed significantly over the period but, as a result of a 54 per cent increase in net current operating earnings before income taxes since 1946, the proportion accounted for by income from inadmissible assets declined from about 30 to about 18 per cent in 1951.

EXCESS PROFITS TAXES OF COMMERCIAL BANKS

SUPPLEMENTARY TABLE I

DISTRIBUTION OF ESTIMATED PROFITS AND CURRENT EARNINGS OF INSURED COMMERCIAL BANKS BY SIZE OF TOTAL CAPITAL ACCOUNTS, 1950 AND 1951 [1]

[Based on data from confidential tax questionnaires of sample banks]

	All groups [1]		Banks with total capital accounts on June 30, 1951 of:							
			$4,000,000 and over [1]		$750,000–$3,999,999		$250,000–$749,999		Less than $250,000	
	1950	1951	1950	1951	1950	1951	1950	1951	1950	1951
DISTRIBUTION OF NET PROFITS										
Dollar amounts (in millions):										
Net profits less State taxes [2]	1,323	1,432	739	818	242	258	201	211	141	145
Federal normal and surtax on taxable income	408	542	240	330	79	102	57	72	32	38
Excess profits taxes on taxable income	15	24	8	10	3	6	3	6	1	2
Net profits after all taxes	900	866	491	478	160	150	141	133	108	105
Cash dividends on common stock	387	413	251	271	58	61	44	47	34	34
Retained net profits	513	453	240	207	102	89	97	86	74	71
Percentages of total capital accounts:										
Net profits less State taxes [2]	12.0	12.2	11.4	12.0	12.1	11.9	12.7	12.6	14.3	13.6
Federal normal and surtax on taxable income	3.7	4.6	3.7	4.8	4.0	4.7	3.6	4.3	3.2	3.5
Excess profits taxes on taxable income	.13	.20	.12	.14	.16	.28	.20	.36	.09	.18
Net profits after all taxes	8.1	7.4	7.6	7.0	8.0	6.9	8.9	8.0	11.0	9.9
Cash dividends on common stock	3.5	3.5	3.9	4.0	2.9	2.8	2.8	2.8	3.4	3.1
Retained net profits	4.6	3.9	3.7	3.0	5.0	4.1	6.1	5.2	7.6	6.7
Percentages of equity invested capital:										
Net profits less State taxes [2]	10.8	11.0	9.8	10.2	11.5	11.3	12.6	12.4	14.8	13.9
Federal normal and surtax on taxable income	3.3	4.2	3.2	4.1	3.8	4.5	3.6	4.2	3.3	3.6
Excess profits taxes on taxable income	.12	.18	.10	.12	.15	.27	.20	.35	.09	.19
Net profits after all taxes	7.4	6.7	6.5	6.0	7.5	6.6	8.8	7.8	11.4	10.2
Cash dividends on common stock	3.2	3.2	3.3	3.4	2.8	2.7	2.8	2.7	3.5	3.2
Retained net profits	4.2	3.5	3.2	2.6	4.8	3.9	6.0	5.1	7.9	6.9
DISTRIBUTION OF NET CURRENT EARNINGS										
Dollar amounts (in millions):										
Net current earnings less State taxes	1,442	1,618	775	912	278	304	231	242	158	160
Allocated Federal normal and surtax [3]	471	639	274	391	94	123	67	84	36	41
Allocated excess profits tax [3]	20	44	10	23	4	10	5	9	1	2
Net current earnings after allocated taxes	952	935	491	498	180	171	160	150	121	116
Cash dividends on common stock	387	413	251	271	58	61	44	47	34	34
Net current earnings less dividends and allocated taxes	565	522	240	227	122	110	116	103	87	82
Percentages of total capital accounts:										
Net current earnings less State taxes	13.0	13.8	11.9	13.4	13.9	14.0	14.7	14.5	15.9	14.9
Allocated Federal normal and surtax [3]	4.2	5.4	4.2	5.7	4.7	5.7	4.2	5.0	3.6	3.9
Allocated excess profits tax [3]	.18	.37	.15	.34	.23	.46	.29	.50	.10	.23
Net current earnings after allocated taxes	8.6	8.0	7.6	7.3	9.0	7.9	10.1	9.0	12.2	10.8
Cash dividends on common stock	3.5	3.5	3.9	4.0	2.9	2.8	2.8	2.8	3.4	3.1
Net current earnings less dividends and allocated taxes	5.1	4.4	3.7	3.3	6.1	5.1	7.3	6.2	8.8	7.7
Percentages of equity invested capital:										
Net current earnings less State taxes	11.8	12.4	10.2	11.4	13.2	13.4	14.5	14.2	16.5	15.3
Allocated Federal normal and surtax [3]	3.8	4.9	3.6	4.9	4.4	5.4	4.2	4.9	3.7	4.0
Allocated excess profits tax [3]	.16	.34	.13	.29	.22	.44	.29	.49	.11	.24
Net current earnings after allocated taxes	7.8	7.2	6.5	6.2	8.6	7.5	10.0	8.8	12.7	11.1
Cash dividends on common stock	3.2	3.2	3.3	3.4	2.8	2.7	2.8	2.7	3.5	3.2
Net current earnings less dividends and allocated taxes	4.6	4.0	3.2	2.8	5.8	4.8	7.2	6.0	9.2	7.9
CAPITAL AND ASSETS (in millions of dollars)										
Total assets [4]	165,249	172,369	96,068	99,373	31,508	33,148	23,496	24,795	14,177	15,053
Total assets less cash assets and U. S. Government securities [4]	64,625	70,932	39,094	42,921	11,570	12,767	8,912	9,715	5,049	5,529
Total capital accounts [4]	11,064	11,744	6,495	6,828	1,998	2,171	1,576	1,674	995	1,071
Equity invested capital [5]	12,233	13,021	7,576	7,994	2,107	2,272	1,594	1,712	956	1,043
CAPITAL RATIOS (in per cent)										
Total capital accounts to total assets	6.7	6.8	6.8	6.9	6.3	6.5	6.7	6.8	7.0	7.1
Total capital accounts to total assets less cash and U. S. Government securities	17.1	16.6	16.6	15.9	17.3	17.0	17.7	17.2	19.7	19.4
Equity invested capital to adjusted total assets [5]	7.3	7.5	7.8	7.9	6.6	6.8	6.8	6.9	6.7	6.9
NUMBER OF BANKS	13,413		284		1,384		3,877		7.868	

[1] Data for banks with total capital accounts of 4 million dollars and over do not include estimates for 5 nonrespondent banks, 16 banks with preferred stock or capital notes or debentures, and one atypical bank. These exclusions are reflected in the "All groups" data. Data for the other size groups are estimates for all insured commercial banks in these size groups.

[2] Comprises net current earnings less the net of capital losses and gains, charge-offs and recoveries, transfers to and from bad debt and other valuation reserves, etc.

[3] This is the estimated hypothetical amount which would have been incurred on net currrent eanings; it is the amount incurred on net profits, adjusted for estimated tax reductions resulting from bond losses, additions to bad debt reserves, etc., but not wholly adjusted for recoveries and other noncurrent income.

[4] End of year.

[5] Excess profits tax basis; see footnote 1 to Supplementary Table 2 on p. 612.

EXCESS PROFITS TAXES OF COMMERCIAL BANKS

SUPPLEMENTARY TABLE 2

SELECTED RATIOS OF INSURED COMMERCIAL BANKS GROUPED BY SIZE OF BANK AND BY RATIO OF EQUITY INVESTED CAPITAL TO ADJUSTED TOTAL ASSETS, 1951 [1]

Capital size and equity-to-total-assets ratio (Per cent)	Number of banks reporting excess profits taxes		Excess profits taxes		Profits and earnings after all taxes but before dividends		Cash dividends on common stock	Profits and earnings retained in capital accounts	
	Incurred on taxable income	Allocated to current earnings	Incurred on taxable income	Allocated to current earnings	Net profits after taxes	Net current earnings after allocated taxes		Retained net profits	Retained net current earnings [2]
	As percentage of all banks in group		As percentage of equity invested capital of all banks in group [3]						
Banks with total capital accounts of $4,000,000 and over and capital ratios of:									
5.0 and under	48	67	.52	.84	7.1	8.3	2.6	4.1	5.1
5.1– 6.0	50	60	.32	.54	7.4	7.9	3.1	4.0	4.9
6.1– 7.0	32	48	.14	.37	7.2	7.3	3.1	3.6	4.1
7.1– 8.0	26	36	.12	.25	6.0	6.6	3.1	2.8	3.5
8.1– 9.0	12	24	.09	.17	5.3	6.1	2.7	2.6	3.5
9.1–10.0	11	22	.05	.18	5.8	5.7	2.9	2.5	2.3
10.1 and over	....	....	....	....	4.4	4.3	3.0	1.2	1.6
All groups	33	41	.19	.36	6.4	6.9	3.0	3.2	3.8
Banks with total capital accounts of $750,000–$3,999,999 and capital ratios of:									
5.0 and under	40	58	.51	.90	8.2	9.7	2.8	5.5	7.0
5.1– 6.0	49	53	.45	.68	7.7	8.6	2.5	5.2	5.8
6.1– 7.0	33	45	.29	.52	7.4	8.2	2.7	4.6	5.2
7.1– 8.0	28	35	.23	.40	5.9	7.1	2.6	3.7	4.9
8.1– 9.0	14	18	.10	.16	5.6	6.7	2.6	3.3	4.0
9.1–10.0	22	32	.13	.23	5.8	6.4	2.6	3.1	3.6
10.1 and over	7	15	.07	.10	5.3	5.9	2.5	2.9	3.1
All groups	30	38	.27	.46	6.7	7.6	2.6	4.0	4.9
Banks with total capital accounts of $250,000–$749,999 and capital ratios of:									
5.0 and under	46	56	.67	.84	8.7	9.9	2.4	6.1	7.8
5.1– 6.0	52	57	.53	.75	8.6	9.5	3.2	5.4	6.8
6.1– 7.0	33	41	.28	.41	8.2	9.2	2.6	5.4	6.4
7.1– 8.0	36	47	.32	.45	8.2	9.0	2.6	5.5	5.7
8.1– 9.0	37	45	.31	.45	7.2	8.7	2.8	4.4	6.1
9.1–10.0	16	26	.08	.14	6.8	7.6	2.8	3.2	3.9
10.1 and over	11	14	.09	.10	5.9	6.0	2.4	3.2	3.6
All groups	37	43	.34	.48	7.9	8.9	2.6	5.1	6.0
Banks with total capital accounts of under $250,000 and capital ratios of:									
5.0 and under	7	7	.23	.33	12.5	13.1	3.5	9.3	9.7
5.1– 6.0	19	21	.19	.25	11.1	12.0	2.6	8.0	8.4
6.1– 7.0	10	10	.13	.14	11.3	12.1	3.4	7.8	8.3
7.1– 8.0	15	15	.12	.15	9.0	10.2	3.0	5.7	7.3
8.1– 9.0	8	11	.10	.13	10.3	10.8	3.1	7.3	7.5
9.1–10.0	5	5	.01	.01	9.6	9.7	2.8	6.3	6.6
10.1 and over	6	9	.04	.04	8.3	8.4	2.6	5.0	5.7
All groups	12	12	.12	.16	10.3	10.9	3.0	7.0	7.5

[1] Equity invested capital is as defined for excess profits tax purposes. It consists of published total capital accounts at the beginning of the taxable year, plus adjustments to put capital on a tax basis, plus the average daily amount of new capital issued during the year. Adjusted total assets are published total assets plus adjustments to put assets on a tax basis. The principal adjustments to published capital and assets are reserves for bad debts and other valuation reserves, and write-offs not allowable for tax purposes. "Equity" and "Total assets" in this table are as thus defined.

[2] Net current earnings less allocated normal tax, surtax, and excess profits tax, and dividends.

[3] The excess profits tax percentages are arithmetic averages of individual bank ratios, because of the number of banks not paying such taxes (which were counted as having zero ratios); the other percentages are medians of individual bank ratios.

APPENDIX

The following pages present reproductions of the Board's press release of December 10, 1951 announcing the study of the effect of taxation on the ability of banks to improve their capital positions, the letter suggested by the Board to be sent by the Federal Reserve Banks to the selected sample banks, and the form of questionnaire and accompanying instructions.

The universe from which the sample was selected consisted of all insured commercial banks. This universe was stratified into four groups based on the following total-capital-account sizes as of June 30, 1951: $4,000,000 and over, $750,000 to $3,999,999, $250,000 to $749,999, and under $250,000. The banks were arrayed by size of total capital accounts within these strata and a systematic sample was selected from a random starting point within each stratum. For the four size groups respectively, the sample was 100 per cent, 33⅓ per cent, 10 per cent, and 5 per cent.[1] This is indicated in the accompanying table which also shows the response to the questionnaire by size groups.

Total capital accounts [1]	Number of insured commercial banks [1]	Percentage of banks included in sample [2]	Percentage of sample banks responding
$4,000,000 and over...	308	100.0	(3)
$750,000–$3,999,999...	1,384	33.3	94
$250,000–$749,999.....	3,877	10.0	88
Under $250,000.......	7,868	5.0	76

[1] As of June 30, 1951.
[2] The sample proportions were reduced slightly by elimination, for technical reasons, of selected banks that had preferred stock, or capital notes, or debentures. Only about 2 per cent of all insured commercial banks held such stock, notes, or debentures on June 30, 1951.
[3] Of the 308 banks in this size group, 5 did not respond, 2 disappeared through consolidation or absorption between June 30, 1951 and the time of submitting questionnaires (figures for these banks were, however, included in the surviving banks' data), 1 bank was excluded because of special circumstances, and 16 banks were excluded because their capital accounts included preferred stock, or capital notes, or debentures. All tabulations for this group are based on the remaining 284 banks.

As can be seen from the table, the degree of nonresponse was not serious, particularly for the larger banks. Tests utilizing known earnings and balance-sheet information indicated that nonrespondent banks were not significantly different from respondent banks.

Except in the largest size group, where adjusted data for the 284 banks described in footnote 3 to the accompanying table were used, data reported by the sample banks were inflated by the relationship of the number of respondent banks to all insured commercial banks in each size group in order to obtain estimates for the size group universe. Spot checks of estimated universe data thus obtained against known data as reported in official condition and earnings reports indicate that the estimates are substantially accurate. For example, 1951 net current operating earnings less State taxes for insured commercial banks (*excluding* the 24 large banks described above) as estimated from the sample data were 1,618 million dollars; the official tabulated figure, for all insured commercial banks (*including* the 24 large banks described above) released by the Federal Deposit Insurance Corporation, was 1,665 million.

Press Release of Board of Governors of the Federal Reserve System

December 7, 1951

(For Release in Morning Papers, December 10, 1951)

The Board of Governors of the Federal Reserve System has transmitted to the Federal Reserve Banks a form of "Confidential Tax Questionnaire" to be distributed by them to a selected sample (approximately 1,500) of insured commercial banks. The purpose of the questionnaire is to obtain factual data for studying the effect of taxation on the ability of banks to improve their capital positions out of earnings and to attract new capital.

The questionnaire was prepared with the cooperation of representatives of other Federal and State agencies and bankers' associations. The collection and tabulation of the data and preparation and analysis of the resulting statistics and estimates will be made by the Federal Reserve Board. The

[1] All banks with total capital accounts of 4 million dollars and over were selected for several reasons: the lack of homogeneity among these very large banks makes estimating hazardous; the 308 banks of this size account for more than 50 per cent of the country's banking business; the size-of-bank range within the group is very wide; and it was understood that large banks utilized primarily the invested capital method for determining excess profits credits. In connection with this last point, it was felt that setting the limit at 4 million dollars *total capital accounts* would comprehend all banks with *equity invested capital* of 5 million dollars or more and thus bring into the sample the group subject to the variable percentage credits permitted under excess profits tax law if the invested capital method is utilized. Under this method excess profits credits (before normal and surtax) are permitted at the rates of 12 per cent for the first 5 million dollars, 10 per cent for the second 5 million, and 8 per cent for the remainder.

tabulations and analyses, by groups of banks, will be made available to the Treasury, all interested Federal and State banking agencies, and bankers' associations.

SUGGESTED LETTER TO BE SENT BY FEDERAL RESERVE BANKS TO SELECTED SAMPLES OF MEMBER AND NONMEMBER BANKS TRANSMITTING "CONFIDENTIAL TAX QUESTIONNAIRE"

To the President of the Bank addressed

Dear Sir:

Enclosed are three copies of a "Confidential Tax Questionnaire" and a copy of related instructions, for your use in reporting certain factual data needed for studying the effect of taxation on the ability of banks to improve their capital positions out of earnings and to attract new capital.

You have no doubt received, or will presently receive, a letter from the American Bankers Association informing you that that Association, the Independent Bankers Association, and the National Association of Bank Auditors and Comptrollers have joined together in sponsoring the study; that the questionnaire has been prepared by the staff of the Board of Governors of the Federal Reserve System with the cooperation of representatives of the Treasury, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Association of Supervisors of State Banks, the American Bankers Association, and the National Association of Bank Auditors and Comptrollers; and that the collection and tabulation of the data and preparation and analysis of the resulting statistics and estimates will be lodged in the Federal Reserve System. The data supplied to the Federal Reserve System for the purpose of the study will, of course, be kept strictly confidential; only the resulting statistics and analyses, which will not reveal the data for individual banks, will be made available to various interested groups and agencies.

To reduce the work load on reporting banks and on the System, it was decided to obtain the data from a selected sample of member and nonmember insured commercial banks rather than from all such banks. The sample was selected in such a manner that reliable estimates for all commercial banks can be made on the basis of data supplied by relatively few banks. Your bank was selected as one of the sample banks.

In work involving samples of this type, it is essential that the data be obtained from all banks to which the inquiry is sent, since they have been selected in a prescribed technical manner. Failure to collect the data from even a few of the sample banks might affect the usefulness of the estimates for all banks. It is, therefore, highly desirable that you supply all the information called for by the enclosed form, even if your bank was not subject to excess profits taxes for the year 1950 and does not appear to be subject to such taxes for the year 1951.

The National Association of Bank Auditors and Comptrollers has offered to provide assistance free of charge for such banks as may require it. There is enclosed a list of representatives of the Association in your area who stand ready to assist if requested. Your correspondents doubtless also will help if you should so desire. These aids and the enclosed instructions should resolve any difficulties you might experience. You will observe, however, that most of the items can be transcribed directly from condition reports, earnings and dividends reports, and tax returns, or are to be based on 1951 estimates of items in such reports.

It will be greatly appreciated by all sponsoring groups if you will complete the enclosed form and return two copies of it to this Federal Reserve Bank within ten days, if at all practicable, of its receipt by you.

Very truly yours,

[Signature of officer of appropriate Federal Reserve Bank]

Enclosures.

Page 1

FEDERAL RESERVE BANK OF ____________________

Budget Bureau
No. 55.5102

Confidential Tax Questionnaire

NAME OF BANK______________________________ CITY AND STATE______________________________

	Related item in earnings and dividends report or 1950 tax return	1950	1951 (Estimated)	Tab. codes
		(In dollars; omit cents)		
1. Net current operating earnings	E&D, item 3			01
2. Profits before income taxes	E&D, item 6			....
3. Income and excess profits taxes (on earnings and dividends report basis):				
a. Write "accrued" or "paid" to show on which basis taxes are reported in E&D report	(See important footnote 1 below)			02
b. State income tax	E&D, item 7			
c. Federal normal and surtax	E&D, item 7			
d. On capital gains, included in item 3c.	(Special instrs.)			
e. Federal excess profits tax	E&D, item 7			......
4. Cash dividends on common stock	E&D, item 13-f, national banks; item 9-b, State			03
5. Net income before net operating loss deduction	1120, line 32 or EP-1, line 1			......
6. Excess profits net income	EP-1, line 23 or Schedule N			04
7. Excess profits credit	EP-1, line 24			
8. Unused excess profits credit adjustment	EP-1, line 25			....
9. Federal income and excess profits tax liabilities (as shown in tax returns):[2]				05
a. Normal and surtax	1120, p. 1, item 35			
b. Tax on capital gains included in item 9a above	(Special instrs.)			
c. Excess profits tax	EP-1, line 38			

[1] Enter E&D tax figures applicable to 1950 and 1951 income. If your bank is on a cash basis, these are the figures which will be reported on 1951 and 1952 E&D reports, respectively.
[2] There can be justifiable differences between items 9 and 3; see instructions.

Page 2

NAME OF BANK______________________________ CITY AND STATE______________________________

	Related schedule in 1950 tax return	1950	1951 (Estimated)	Tab. codes
10. Excess profits tax credit method used		Check one for each year		
a. Minimum $25,000 credit used in lieu of b or c below	EP-1 or Schedule N			
b. Income method				
(1) General average	EP-2			
(2) Growth credit	EP-2			
(3) Industry rate of return	EP-5 (A, B, C, D)			
c. Invested capital method				
(1) "Asset" method	EP-4			
(2) "Historical" method	EP-4			...
		In dollars; omit cents		
11. Average base period excess profits net income	EP-2, line 26 or 31			06 ....
12. Effect of certain items on Federal income taxes as shown in item 3 of this report:				07
a. Reduction in income subject to Federal income taxes resulting from—				
(1) Additions to bad debt reserves				
(2) Bond losses, net				
(3) Other losses and charge-offs				
(4) Substantial nonrecurring expenses				....
b. Additional Federal income tax liabilities which would have been incurred if the amounts shown in item 12a had been included in income subject to tax—				08
(1) Normal and surtax				
(2) Excess profits tax				....
13. Cash, bank balances, etc. *at end of year*	Cond. Report, item 1			09
14. Total U. S. Govt. obligations *at end of year*	Cond. Report, item 2			....

EXCESS PROFITS TAXES OF COMMERCIAL BANKS

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	Related item in condition report, earnings report, or 1950 tax return	1950	1951 (Estimated)	Tab.¶ codes
		(In dollars; omit cents)		
15. Total capital accounts at beginning of year	C.R., item 29	____	____	10 and 11
16. Adjustments of capital accounts to excess profits tax basis				
a. Reserve for bad debts	E&D, Sched. D	____	____	
b. Other valuation reserves on loans and securities	E&D, Sched. D	____	____	
c. Other adjustments to tax basis (do not include borrowings)	(Special instrs.)	____	____	
17. Adjusted capital accounts (before new capital)	(15 plus 16, this form) (Same as EP-4, line 1)	____	____	
18. Equity invested capital for excess profits tax purposes (including new capital)	EP-4, lines 1 plus 2, or line 53	____	____	
19. 75% of average borrowed capital as defined for excess profits tax purposes	EP-4, line 3(b) or line 54			

20. Net current operating earnings, applicable taxes, and capital accounts: (Tab. codes 12, 13, 14 and 15)

Year	Net current operating earnings (same basis as item 1 of this report) (1)	Approx. State and Federal income taxes (excl. excess profits taxes) applicable to Column (1) (2)	Dates	Total capital accounts (C.R. item 29) (3)	Adjusted capital accounts (same basis as item 17 above) (4)
	(In dollars; omit cents)				
1946	____	____	12-31-45	____	____
1947	____	____	12-31-46	____	____
1948	____	____	12-31-47	____	____
1949	____	____	12-31-48	____	____
1950	____	____	12-31-49	____	____
1951 (Est.)	____	____	12-31-50	____	____
			12-31-51 (Est.)		

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21. Total assets and inadmissible assets:

Report of condition	Total assets (C.R. item 12)	U. S. Govt. wholly and partially tax-exempt obligations (part of C.R. item 2)	Obligations of States & Pol. subdivs. (C.R. item 3)	Corporate stocks (C.R. item 5)	Income from inadmissible assets (part of item 1-a in E&D report)	Tab. codes
	(In dollars; omit cents)					
6-30-46	____	____	____	____	1946____	16
12-31-46	____	____	____	____	1947____	17
12-31-47	____	____	____	____	1948____	18
12-31-48	____	____	____	____	1949____	19
12-31-49	____	____	____	____	1950____	and
12-31-50	____	____	____	____	1951____	20
12-31-51 (Est.)	____	____	____	____	(Est.)	

22. Issues of new common capital stock, excluding stock dividends, during 1946–1951 (if none, so indicate): 21
   a. Year issued ______ Amount issued (at issue price) $__________
   b. Amount purchased by then existing shareholders (at issue price) __________
   c. Price per share at which issued __________
   d. Market price per share before issuance (if available) __________
   e. Book value per share before issuance, based on adjusted capital accounts (same basis as item 17) __________

23. Data concerning common shares (if available): 22
   a. Number of common shares which will be outstanding on December 31, 1951 __________
   b. Number outstanding on date of quotation below __________
   c. Latest market price $______, or bid price $______ Date__________
   d. Source of market or bid price quotation (check one):
      Stock exchange ______ Established over-the-counter market ______
      Private sales ______
   e. Latest reported sale price ______ Date ______
   f. Estimated number of common shares traded during 1951 __________
   g. Number of common shareholders on latest available date __________

______________________ (Name and title) ______________________ (Signature)

FEDERAL RESERVE BANK OF

December 1951.

Instructions—Confidential Tax Questionnaire

The importance of completing all items on the questionnaire has been stressed in the letters you have received on the subject. This applies regardless of whether or not your bank paid excess profits taxes on 1950 income and whether or not you expect to pay such taxes on 1951 income.

Most of the information requested can be obtained from Reports of Condition, Earnings and Dividends Reports, or corporate tax returns. Wherever possible, references to the sources of information are made in the second column of the questionnaire; in other cases, the questions are self-explanatory; and in still others, special instructions are given below. The abbreviation "E&D" on the questionnaire refers to earnings and dividends report; "C.R." refers to condition report; "1120" refers to U. S. Treasury Department Internal Revenue Service Form 1120 (Corporation Income Tax Return); "EP" refers to Schedule EP of Form 1120 (Computation of Corporation Excess Profits Tax); the number following "EP" refers to the appropriate schedule of the EP form; Schedule N is a separate mimeographed schedule to Form 1120 which may be used in lieu of the EP schedule if the total excess profits net income is $25,000 or less; and "Special instrs." indicates that the instructions below contain some details relative to completing the items so indicated.

General

All items should be completed; and in instances where the figures to be reported are zero, the word "none" should be inserted. The report should be signed by the officer or employee of your bank to whom inquiries may be addressed if that should be necessary. Normally, this would be the person within your bank who is most familiar with your reply to the questionnaire.

If the bank has filed an amended tax return in any year, it is necessary that the amended figures be reported. In connection with both 1950 and 1951 figures it should be noted that the Revenue Act was recently amended retroactively; and figures should be reported in accordance with the amended law. For figures which must be estimated, your best estimate, based on available information, is required. If you should so desire, the completed questionnaire may be accompanied by a statement or supplement showing how you arrived at some or all of the estimated figures.

Mergers, consolidations, and absorptions

In the event your bank was involved in a merger, absorption or consolidation in 1950 or 1951, the figures reported for these two years should be on a basis comparable to the present organization of the reporting bank. By way of example, if your bank absorbed another bank on December 31, 1950, it would be necessary to combine 1950 net current operating earnings for *both* original banks in order to arrive at a 1950 figure comparable to the 1951 figure for the present bank. Similar reasoning should be used in arriving at figures comparable to those of the present bank for the other items on the questionnaire and for different dates of merger, consolidation, or absorption. In all such cases, your completed questionnaire should be accompanied by a supplement indicating how the comparable figures were arrived at.

For items 20 and 21 on the questionnaire, which require data back to 1946, the same reasoning as above should be applied in the event your bank was involved in one or more mergers, consolidations, or absorptions in the years 1946-1949. If applicable, a supplement showing the composition of the figures in these two questions should also be attached to your completed questionnaire.

Item 3

As indicated in footnote 1, page 1, it is important that the taxes applicable to 1950 and 1951 income be reported. This requires some special consideration by banks on a "paid" or "cash" basis rather than an accrual basis. For these banks, taxes reported in the earnings and dividends report for any year will be taxes paid on the previous year's income. In the questionnaire, therefore, the earnings and dividend basis taxes for banks on a "cash" rather than an accrual tax reporting system will be the figures expected to be reported in the 1951 and 1952 earnings and dividends reports, respectively.

For banks on an accrual tax reporting system, the figures required by the questionnaire are those reported or expected to be reported in 1950 and 1951 earnings and dividends reports.

Question 3d

The figures reported should be those portions of the amounts reported or to be reported in earnings and dividends reports item 7 which are applicable to capital gains rather than to current operating income. See instruction below under question 9b.

Question 8

An unused credit in any one year may be carried forward or backward. Note that no adjustment may be made for an unused minimum credit of $25,000.

Item 9

The amounts reported under item 9 are the actual figures from your tax return, rather than the amounts from earnings and dividends reports which were reported under item 3 above. Figures reported under this heading (tax return basis) may differ from those reported under item 3 (earnings and dividends report basis), because of provision in earnings reports for amounts to cover possible tax payments for items still under consideration, adjustments in earnings reports for over-accruals in past years, adjustments for refunds, or because of the fact that earnings reports are normally prepared well in advance of tax returns.

Question 9b

Capital gains, both short- and long-term, are shown in the corporation income tax return (Form 1120) as items 12(a) and 12(b), respectively. Both are included in the computation of normal tax and surtax, unless the alternative tax on long-term capital gains (per Schedule C of Form 1120) produces a lesser tax. The tax to be shown on the questionnaire should be either:

1. If alternative tax on net long-term capital gains was *not* computed on Schedule C of Form 1120, enter tax computed at the applicable normal and surtax rates on total net short-term and long-term capital gains (items 12(a) and 12(b) of Form 1120).

or

2. If alternative tax on net long-term capital gains *was* computed on Schedule C of Form 1120, enter tax reported at item 19 of this Schedule *plus* tax computed at the applicable normal and surtax rates on net short-term capital gains (item 12(a) of Form 1120).

Item 12

These questions are being asked to determine the effect of certain extraordinary deductions on income taxes in order that conclusions can be drawn as to the effect of taxes on normal operating income. There should be entered, under 12(a), reductions *in income* due to special items and, under 12(b), the amounts of additional Federal income tax liabilities which would have been incurred if these reductions had been included in income subject to tax.

Question 15

Note that total capital accounts at the *beginning* of 1950 and 1951 are required—i.e., as of December 31, 1949 and 1950, respectively.

Item 16

The purpose of item 16 is to adjust beginning-of-year capital accounts from a Condition Report basis to a tax return basis and, therefore, adjustments should also be beginning-of-year figures. Important items involved are the reserves appearing in Section D of the Earnings and Dividends report; these are covered by questions 16a and b. Figures reported in question 16c, "other adjustments," should include differences (due to charge-offs, write-downs, etc.) between the value of assets as shown on the Condition Report and their value for income tax purposes. For example, a building carried on the books at $1 would require the difference between the $1 and the tax depreciated value of the building to be added back to capital accounts as shown in condition reports. Also under item 16c there should be reported amounts necessary to reflect other adjustments of assets or liabilities in order to put them on a tax basis.

Question 17

The amount reported under question 17 will be the amount which, under excess profits tax law, represents the true equity of stockholders in your bank at the beginning of the taxable year (before any adjustments for new capital paid in during the year in question). The amount will be the same as that reported or to be reported in Schedule EP-4, line 1; it will equal the total of amounts entered under questions 15 and 16.

Question 18

The equity invested capital reported under question 18 is the amount reported under item 17 plus adjustments for new capital paid in during the year. These adjustments should be on the basis of the average for the year as called for by the EP-4 Schedule.

Question 20, column (2)

The purpose of this column is to determine the total State and Federal income tax (i.e., excluding taxes on excess profits and capital gains) applicable to net current operating earnings only. For 1950 and 1951, the figures will be the same as the totals of items 3b plus 3c plus 12b(1) less 3d.

Question 20, column (4)

The adjusted capital accounts (same basis as item 17 of the questionnaire) should, for the years 1945-1949, be your best estimate taking into account the adjustments mentioned under item 16 which apply in each of the years.

Question 21

Report in column 5, "Income from inadmissible assets," the total amount of income derived from the assets included in columns 2, 3, and 4 of this question.

NOTE

If copies of the 1950 EP Schedule (for taxable years ending after June 30, 1950 and before December 31, 1951) and/or related Internal Revenue instructions are not available in the bank's files and are needed as aids in completing the questionnaire, they should be requested from the nearest Collector of Internal Revenue or the Federal Reserve Bank.