Impact of the
EXCESS PROFITS TAX
of 1950

November 1952

The Tax Foundation
30 Rockefeller Plaza
New York 20, N. Y.
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Business has been operating under the Excess Profits Tax Act of 1950 for nearly two years. Actual experience has borne out the validity of the strong arguments made against the tax when it was proposed. As the date of its expiration nears (June 30, 1953) these arguments merit re-examination in the light of specific company or industry experience.

Limited examination of corporate annual reports and national magazines reveals numerous instances of management difficulties in trying to run a business successfully in the face of the many defects in the Excess Profits Tax Act. Statements from some 85 companies in a dozen industries re-emphasize the arguments made two years ago.

The major argument against EPT, supported by many case histories, is that by severely penalizing small or growing companies the tax inevitably retards expansion of the economy. Similarly, established companies complain that EPT kills any incentive for plant expansion or for increased production in existing plants. Companies in diversified fields report that EPT prevents the expansion of productive capacity in two other ways: it limits capital available for reinvestment and repels outside investors by reducing profits and dividends available for distribution to stockholders.

The tax further strangles productive effort by effecting a tax-orientation of management. Elimination of the profit motive as an incentive to cut production costs and avoid extravagance results in managerial decisions not wholly based on sound business considerations of efficient, low-cost production. At the same time, this factor contributes to inflation by exerting an upward pressure on prices, stimulating competitive bidding for scarce manpower and materials, and encouraging debt.
From a purely mechanical standpoint, experience demonstrates that EPT is difficult to administer and does not provide adequate relief in inequitable or harsh cases. Not only does EPT greatly increase the accounting burden, controversy, litigation and cost of compliance, but it makes extensive research necessary in the fields of economics, business and related subjects in order to settle tax liability.

Short of an amendment to the law, it is difficult or practically impossible to grant relief in those cases where the tax has a particularly harsh impact. Ample evidence of this fact lies in the 23 technical and structural changes made in the Excess Profits Tax Act by the Revenue Act of 1951— with special provisions for companies that had been able to convince the tax-writing Congressional committees of particular injustices.

The result is not one broad excess profits tax law for the whole corporate economy but a series of individual excess profits tax provisions for specific industries. Since every month brings to light more and more inequities, the law seems destined to become a hodge-podge of special provisions.

The generally unsatisfactory results of EPT have prompted current efforts to let the law die on its expiration date next June.
I. The Excess Profits Tax Retards the Growth of the American Economy.

A. EPT penalizes small and/or growing companies.

B. EPT kills incentive for plant expansion or for increased production.

C. EPT has a detrimental effect on a company's competitive position and earning power.

D. EPT limits capital available for reinvestment, thereby preventing expansion of productive capacity.

E. EPT repels outside investors because of the reduced profits and dividends available for distribution to stockholders.

II. The Excess Profits Tax Strangles Productive Effort by Bringing About a Tax-Orientation of Management.

A. EPT removes the profit motive as an incentive to cut production costs and avoid waste and extravagance, so that managerial decisions are not wholly based on sound business considerations of efficient, low-cost production.

B. EPT encourages current business expenses that are too speculative under ordinary tax circumstances.

1. EPT encourages research on questionable new products and new designs.

2. EPT encourages unnecessarily heightened efforts for product promotion and institutional and public relations.

3. EPT encourages highly speculative exploration for new sources of raw materials.

4. EPT fosters increased maintenance charges for building and machinery repair.

5. EPT encourages prodigality in benefit plans.

C. EPT impels charitable gifts of stockholders' profits at bargain prices.

D. EPT promotes unwise corporate reorganizations and other changes in the corporate set-up.
III. The Excess Profits Tax Burdens the Economy by Contributing to Inflation.

A. EPT exerts an upward pressure on prices.

B. EPT stimulates competitive bidding for scarce manpower and scarce materials.

C. EPT encourages debt and discourages thrift.

IV. The Excess Profits Tax Is Difficult to Administer.

A. EPT makes extensive research necessary in the fields of economics, business and related subjects to settle tax liability.

B. EPT does not provide adequate relief in harsh cases.

C. EPT greatly increases the accounting burden, controversy, litigation, and the cost of compliance with taxes.
I. THE EXCESS PROFITS TAX ACT RETARDS THE GROWTH OF THE AMERICAN ECONOMY

General

"...A general freezing of the structure of industry is an almost inevitable consequence of any long-continued system of excess profits taxation... which does not permit profits to increase in line with the equity interest.... The freezing referred to here is a situation in which an indefinite continuation of excess profits taxation would further increase the tendency for expansion to be limited to that which can be financed by borrowing or such retained earnings as might be available after taxes."

Source: Smith, Dan Throop, Effects of Taxation, Corporate Financial Policy, Boston: Harvard University, Graduate School of Business Administration, 1952, p. 119.

A. EPT PENALIZES SMALL AND/OR GROWING COMPANIES.

General

"The most undesirable feature of EPT is that smaller companies are prevented by high taxes from growing," says an automobile manufacturer."


* * *

"Growing companies frequently are penalized, because the excess-profits tax is based on the increase in earnings over a base period in the late '40s. "A big company with declining profits may be free from EPT. Its smaller, growing competitor gets stuck."


* * *

Aluminum

"During the 4 years 1946 through 1949 Reynolds spent nearly $95,000,000 for new plant and facilities. From the beginning to the end of the base period the Reynolds investment in plant and equipment increased more than four times.

"After the war Reynolds sought to secure markets for primary production because it was a new producer of aluminum with no established outlets. Many new end products were manufactured, and heavy promotional expenses absorbed part of the earnings of the reduction and fabricating divisions. During the base period Reynolds was experimenting with, developing, and exploiting new products. ..."
"Furthermore, the enormous expansion represented by the postwar quadrupling of its investment in plant and facilities required time for integration and scheduling into an economical and efficient operation."

... ...

"In total this expansion was a heavy undertaking. The result is that Reynolds was a low-profit operation throughout the base period. Wholly aside from the events in Korea and the defense demands of the country, Reynolds had been confidently looking forward to the latter part of 1950 and the year 1951 as the time when it would begin to realize the profit normally and reasonably to be expected from these extensive undertakings. The soundness of this view was being demonstrated by the facts. Even prior to Korea the demands made upon it were exceeding its expanded capacity.

"The result of these circumstances is that Reynolds has been in a solid but costly state of expansion and integration that would have yielded increased production and profit now and in the immediate future without the occurrence of any of the present critical developments of defense mobilization. The result is also that Reynolds typifies a growth company for which no formula of relief has been enacted. The Excess Profits Tax Act is inflicting a heavy penalty on Reynolds, and at the very time when it is making its maximum effort for defense."

Source: Statement of Mr. Richard S. Reynolds, Jr., President of Reynolds Metals Co., in Hearings, before the Committee on Finance, U.S. Senate, 82nd Congress, 1st. Session, on Revenue Act of 1951, Part 3, pp. 1570-1571,

*Baking*

"Since your company has had considerable growth in the last four years, it has been more seriously affected by excess profits taxes than those companies whose sales and earnings have reached a plateau and have leveled off. The present tax laws give but minor relief to companies such as your own, who are in a growth stage. The amount of this relief is neither equitable nor adequate. Our business has not actually increased as a direct consequence of the Korean war, and your Company feels that an excess profits tax on its earnings, is not consistent with the spirit and intention of such laws."


* * *

*Chemicals*

"The 'excess profits' tax imposes a specific penalty on growth and efficiency by taking away most of the earnings from new operations and from technological improvements..."


* * *
Coated Abrasives and Tape

"The excess profits tax imposes a heavy penalty upon a growth company such as ours which has had a steady growth pattern for years as a result of constant research and reinvestment of earnings to provide facilities for manufacturing new products resulting from research."


* * *

Drugs

"The case of one of our units will serve to illustrate the point. This division was acquired as a small company fourteen years ago and continuous efforts have been devoted to building it into a larger, stronger company. We have been very successful in building sales volume but we have not achieved commensurate success in increasing earnings after taxes. During eight of the last fourteen years this particular division has had to pay taxes on so-called excess profits and the total taxes in these eight years have been equivalent to 62% of the earnings before taxes.

"We strongly question the justice of a tax system which so seriously penalizes a small company for developing new products and expanding the area of its service to the consuming public."

Source: Vicks Chemical Company, Annual Report to Stockholders, for the year ended June 30, 1952, p. 6.

* * *

Electric Cables

"...Excess Profits Taxes equalled $1,150,000 an increase of $650,000 above the previous year...."

...It has been the practice of your company to finance expansion and improvement programs very largely from earnings retained in the business. We are all deeply conscious of the necessity of taxes to pay for the defense effort, but the penalty of such heavy taxation as above indicated on a growth company is an exceedingly heavy burden."

Source: Rome Cable Corporation, Annual Report as of March 31, 1952, p. 3.

* * *

Kitchenware

"...excess profits taxes...affect a growing company most sharply..."


* * *
Office Equipment

"...the treasurer of an office-equipment firm notes that 'it seems only those companies will be severely penalized which have not been established long enough to create a good credit base.'"


* * *

Paper

"...We believe... that the principle embodied in the present tax structure, of raising major revenues by means of the so-called 'excess' profits tax, is not only inequitable, but also basically unsound because of the heavy penalties it places on initiative, efficiency and growth.

"The name of this tax is in itself misleading. It is not a levy exclusively, or even primarily, on 'windfall' profits resulting from the war. Its true effect is to graduate the rate of corporate taxes so as to tax most heavily those corporations which show the most improvement since a given 'base period', whether they have achieved that improvement through unusual skill, initiative, risk-taking, or otherwise."


* * *

Publishing

"...The term 'Excess Profits' as applied to these dollars of current income is a cruel misnomer, and this form of tax is not only unfair and unsound, it also penalizes Company growth."


* * *

Rubber

"These figures emphasize the severity of existing corporate and excess profits taxes upon a growing company which did not have the benefit of exceptional profits during the immediate post war years."


* * *

Rubber Products

"...by the failure of the Act to give recognition to...economic reality, our company along with many others is being further penalized for entering a new field for otherwise our base period earnings would have been substantially greater without the absorption of the losses of Restfoam in the first three years of the base period. The effect of this inequity is now being
felt severely. This is so even though the relief provisions of the Act were
designed to prevent normal earnings from being considered excess profits. Our
yearly earnings after taxes since 1950 are less than the average for the base
period years and much less than the industry rate of return. This has resulted
in unduly and unjustifiably stifling our present growth. Our ability to com-
pete with the major companies in our field has lessened...."

Source: Letter of Mr. Herman M. Scheefer, Tax Attorney for
Hewitt-Robins, Inc., March 11, 1952, containing pro-
posed testimony before Senate Finance Committee.

* * *

"By putting money back into business and planning carefully, we have
employed more and more men and women at high wages enough to encourage their
best effort... Our economic system is supposed to reward a growing company
providing useful products at reasonable prices, but just the reverse has been
true in our case. During the 1946-1949 period on which excess profits taxes
are based, we were making little profit, but were trying to build a sounder
Company, looking to the future rather than the immediate gain.

"This enterprise paid off in the year ended on June 30, 1951, when
our profits before taxes reached adequate levels for the first time since the
war, only to be drained away by normal and excess profits taxes...which com-
pletely prevented the creation of adequate reserves."


* * *

Silver Mining

"These new rates together with the excess profits tax, constitute a
tax structure which will effectively restrict the growth of most companies and
endanger their ability to pay a fair rate of return to their stockholders."


* * *

Soap

"In regard to the taxes which we pay, we can only repeat that in our
judgment the Excess Profits Tax is a most unfortunate kind of taxation. It is
wrong and is an unsound procedure on the part of the government. It stifles
the growth of both small and large companies and this in turn, of course,
weakens the industrial fabric of our country...."

Source: The Procter & Gamble Company, Statement of Year

* * *

Supermarket Grocery

"Like other growing companies whose earnings were moderate in tax
base years, Food Fair has been penalized by the excess profits tax. Taken in
conjunction with restricted profit margins and with the general increase in the
Federal income tax rate, this factor caused in the latest fiscal year a profit experience contrary to sales results.


* * *

Synthetic Textiles

"During each year from 1946 through 1949, the company's earnings were seriously depressed by this program for expanding facilities for insulation and by high research and market development costs undertaken to utilize excess facilities for Fiberglas textiles."

* * *

"During this period, profits were sacrificed in extraordinary expenditures for research, market development and personnel training, and earnings were plowed back into improved facilities and plant expansion. However, under the formula provided in the Revenue Act of 1950, those 1946-1949 years are the ones selected as the yardstick by which 'normal' earnings are measured. Earnings above that measure in 1950 and 1951 are defined as 'excessive.'

"The company is thus heavily penalized, in competition with mature and well-established companies who faced no comparable reconversion problems, and were in a position following World War II to take immediate profitable advantage of the pent-up civilian demands. As a result, the tax base years established by the Act are more favorable to them, and a smaller part of their 1950-1951 earnings are taxed as excessive."


* * *

Woodworking Tools

"...the law has the effect of classing all new growing businesses begun in the postwar period with companies whose earnings are abnormally high because of the impact of the Korean situation. Far from being helped by war conditions, our business has been substantially pinched by shortages of critical materials...."

"In 1948 our sales were $3 million. In 1949 they rose to over $3,500,000, and in 1950 to over $5 million.

"I might add that had it not been for Korea our sales would have approached $6 million.

"Under the provisions of the existing law we find ourselves facing taxes which may be as high as 62 percent, possibly to be raised to 70 percent, and we are thus classed with businesses whose profits are swollen either directly or indirectly as a result of war conditions.

"Gentlemen, we simply cannot exist, much less grow, under the impact of that type of taxation, for book profits to an expanding enterprise are never
represented by cash dollars in the bank, but in inventories, plant tooling, and receivables. We have never felt we were in a position to even consider paying a dividend.

"...We are not even eligible for the benefits of the so-called growth formula because we were not in business on January 1, 1946."

Source: Statement of Mr. Frank G. Chambers, Treasurer Magna Engineering Corp., in Hearings, before the Committee on Finance, U.S. Senate, 82nd Congress, 1st Sess. on Revenue Act of 1951, Part 3, pp. 1698, 1699. (apparently corrected by 1951 amendment)

* * *

B. EPT KILLS INCENTIVE FOR PLANT EXPANSION OR FOR INCREASED PRODUCTION.

General

"By discouraging incentives to produce, the excess-profits tax places an undue restraint on our whole industrial economy." (Steel)


* * *

Chain Retailing

"The Company now has satisfactory facilities for many years to come in a large number of communities. On the other hand, a progressive business never stops expanding. Old stores, warehouses, and equipment become obsolete or wear out, and the new properties are almost invariably more extensive than those they replace. However, the management wishes to re-emphasize that because of existing governmental restrictions on commercial construction and because of inadequate return on investment under present Federal taxation further broad expansion will be held in abeyance....

"The management recognizes the need for high taxes in this period of rearmament, but points out that such a tax burden penalizes efficiency and growth. In the case of Sears some of the increased earnings resulting from the expansion program of prior years are only now being realized, and under the present tax law 82 percent must be paid to the government. The effect of this large tax assessment is to stop further expansion and to deny stockholders a fair return on their investment in additional facilities. To illustrate the impact of the excess profits tax on the Company: in 1950 and 1951 this tax approximated $43,900,000, an amount which could have built six of the larger "A" stores and nine medium-size "B" stores, giving employment to approximately 6,000 additional persons.


* * *
Chemicals

"...it is having the effect of slowing down production, not only with my business, but with other little firms scattered around me.

"The employees lose the incentive of producing any more. They know that I cannot pay them any more because I am restricted under the wage laws, and there is no incentive on my part as a manager to put any more capital investment and improve our facilities to get more out of what we are doing now. There is just no incentive for doing that, sir.

"It just means tying up capital, and we get nothing from it whatsoever; end, in addition to that, there is no incentive even to make our present operation any more efficient. We just do not want to do any more, and it completely obviates any expansion."

Source: Statement of Mr. Carl Wittichen, Jr., Wittichen Chemical Co., in Hearings before the Committee on Finance, U.S. Senate, 82nd Congress, 1st Sess., 1951, on Revenue Act of 1951, Part 2, pp. 412-413.

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Natural Gasoline

"Consequently, the tax rates which we now have are discouraging increase of the business and are actually causing the natural gasoline business to retrench and to contract its activities rather than to expand them.

"In order that natural gasoline companies may continue to operate and to expand their facilities for producing natural gasoline and other products essential for the production of aviation gasoline, synthetic rubber and for fuel, it is essential that the Government set the tax rate at such a point as will encourage business to expand its facilities. Inasmuch as our company was not in full operation during any part of the base period, our excess-profits-tax base is so low that we are faced with the maximum excess-profits tax rate which at present is 62 percent...."

Source: Statement of Mr. Louis F. Booker, Jr., Comptroller, Texas Natural Gasoline Corp., Tulsa, Okla., in Hearings before the Committee on Ways and Means, House of Representatives, 82nd Congress, 1st Sess., on Revenue Revision of 1951, p. 1215. (possibly corrected by 1951 amendments).

* * *

Paper

"In our own case, with this tax in effect, and with our earnings before taxes in the same general range as last year, out of every additional dollar we might earn by more effective use of our present facilities, 77 cents would have to be paid to the Federal Government. Of even greater overall importance is the discouraging effect such a tax has on further capital investment...."
"This tax does, indeed, remove much of the incentive that has activated the growth of your company and its customers in the past...."


* * *

Parts

"If our present level of business continues throughout the coming fiscal year, we will just barely touch the excess profits tax bracket. What is it that drives us to obtain a greater volume? Perhaps it is habit and pride, or maybe it is because we don't know any better! Certainly there is no incentive for the Company or its management to make more money nor is there the wish to turn over more tax dollars to government. We are troubled with the thought that excessive taxation is limiting the incentive and reward that junior management should have if they are successfully to take our places in this Company and the other industries of our country."


* * *

Petroleum

"There's the case of an oil company that had a new $15-million refinery on the drawing boards. It promised to pay for itself -- leaving taxes out of account -- in two or three years. But the company operates in the peak excess profits tax bracket. After taxes, it figures, the refinery would take at least 10 years to pay for itself. And the chances that some still-to-be developed process would obsolete the new plant in that time were too good. The company dropped the project."


* * *

C. EPT HAS A DETRIMENTAL EFFECT ON A COMPANY'S COMPETITIVE POSITION AND EARNING POWER.

General

"...the tax will cause either the abandonment of contemplated increases in dividend rates or lowered dividends."


* * *

Aircraft

"Additional work will bring more gross earnings to your company but the net income available for dividends will not increase proportionately with the gross earnings due to the impact of income and excess profits taxes...."
"A tax law that leaves the company and therefore its stockholders very little by way of increased net earnings for its efforts to the point of more than doubling its present volume of production—an effort which would require capital expenditures and would put great strain on organization—would seem too much to penalize efficiency and enterprise."


* * *

Cellophane

"The change is particularly important to companies established in one field who enter an entirely new field. In such a situation the overall limitation would not ordinarily apply and all of the earnings of the new product would be taxed at the suggested confiscatory rate of 82 percent. In the case of Ecusta the change which became a reality in June 1951, was planned as early as October 1948 and its parent corporation was legally committed to make the change on November 4, 1949, while the legally binding contract was assigned to Ecusta on March 6, 1950. All of Ecusta's anticipated cellophane profits will be taxed at 82 percent for the reasons set out above and because based upon the best possible present estimates and the over-all tax limitation of 70 percent will provide no relief whatsoever. This places Ecusta in a position where it is virtually impossible for its cellophane operation to survive in a competitive market where its competitors were manufacturing cellophane throughout the entire base period and therefore enjoy a fair and normal excess profits credit. Of course, this is a condition under which a business cannot survive...."


* * *

Natural Gasoline

"The trend of the present law is definitely toward monopoly and the absorption of small, new companies by larger, older ones. The larger older companies with substantial earnings records have substantial base periods and correspondingly substantial allowable excess-profits-tax credits. However, small, new companies are subject to tax at the maximum rates, lacking earnings records to give them adequate base periods...."

"This leaves them at the mercy of larger, older competitors and makes the inevitable trend toward monopoly and the absorption of small, new companies by larger, older ones."

Source: Statement of Mr. John T. Oxley, President, Texas Natural Gasoline Corp., in Hearings before the Committee on Finance, U.S. Senate, 82d Congress, 1st Sess., on Revenue Act of 1951, Part 3, pp. 1810, 1812. (possibly corrected by 1951 amendments).

* * *
"According to a paper manufacturer, ... the 'cheap dollar makes equipment improvement and replacement more difficult and for this reason alone makes the maintenance of a top-notch competitive position difficult."


* * *

Synthetic Textiles

"Third, we will be unable to compete on equal terms with much older and well-established companies in our respective fields. And that is a very important matter to us.

"In 1950, one of the largest companies in the insulation field had only 20 percent of its income subject to excess-profits tax. Another principal competitor in textiles had only 28 percent subject to excess-profits tax.

"In contrast, we had $2\frac{1}{2}$ percent subject to excess-profits tax.

"I would like to emphasize that very strongly, because the crux of it is in there. Over a period of years you cannot remain competitive under those circumstances."

Source: Statement of Mr. Harold Boceschenstein, President, Owens-Corning Fiberglas Corp., in Hearings before the Committee on Finance, U.S. Senate, 82d Congress, 1st Sess., on Revenue Act of 1951, Part 3, p. 1594.

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D. EPT LIMITS CAPITAL AVAILABLE FOR REINVESTMENT, THEREBY PREVENTING EXPANSION OF PRODUCTIVE CAPACITY.

General

"... it has become increasingly difficult for a business to finance expansion out of retained earnings, as corporation tax rates have been pushed over 50%. The special taxes... on so-called 'excess profits,' where applicable, have made this problem even worse."


* * *

"Another and important field in which the tax differential plays a part is rapid (five-year) amortization of new plants constructed in connection with the defense program. Here again the EPT company enjoys a decided advantage; and I am sure that it will be found that the great majority of companies which have applied for the required certifications are companies subject to EPT."

Air Conditioning

"'There is so little left after the E.P.T. bite that it is almost impossible to increase working capital sufficiently to meet the present enlarged demands of our business.' (Air conditioning)"


* * *

Architectural Metals

"In 1951 Federal Income and Excess Profits Taxes amounted to $5.89 per share and on slightly higher earnings in 1950 the total was $4.88 per share...This extra tax burden will handicap corporate growth from earnings and will force more and more companies to look to other sources for financing...."

... The burden of Federal Income and Excess Profits Taxes is demonstrated by our operating figures for 1951. Ours is not an extreme case because we feel we are more fortunate than many businesses in our Excess Profits Tax base....Industrial expansion financed out of earnings is practically impossible under these circumstances. In fact it is even extremely difficult to maintain existing plants and equipment in first class shape....Industry is being forced to outside financing either by bringing additional capital into the business or through borrowing."


* * *

Cereal

"...the complicated excess profits taxes...added to the steadily decreasing purchasing power of the dollar, are making it very difficult for business, large and small, to pay the owners dividends that represent a reasonable return on their investment and have left sufficient cash to provide the necessary working capital and the money required to maintain and expand plant facilities as the business grows."


* * *

Chemicals

"As growth companies, basic chemical companies generally are accruing taxes at or close to the ceiling rate. Thus, modification or removal would benefit the industry and permit the retention of more funds for growth needs...."


* * *
"For many years expansion of the Company's productive capacity has been financed with funds derived largely from earnings retained in the business, and from increases in reserves. The enlarged demand for the Company's products cannot be ignored and new productive facilities must be provided to the extent possible. However, the 'excess profits' tax bears heavily upon earnings available for financing new facilities."


* * *

Drugs

"The combined income and surtax rate (so-called normal taxes) which applies to the earnings of most corporations is now 52%...an additional 30% is applied to so-called 'Excess Profits.' The starting point for computing 'Excess Profits' is 83% of the average earnings of three base years.

"This presents a severe handicap to the development of any business whose growth is financed by its own earnings."

Source: Vicks Chemical Company, Annual Report to Stockholders, for the year ended June 30, 1952, p. 6.

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Electrical Motors and Generators

"Excess Profits Tax rates establish ceilings that make unavailable earnings that should feed the growth of and secure your investment in American industry."


* * *

Electronics

"...The demands on working capital have been stringent and they will probably continue to exist for some time until our V-loan and other indebtedness can be reduced. Present so-called 'excess profits' tax rates make it very difficult to build up working capital...."


* * *

Heating and Air-conditioning Controls

"The present high Federal taxes, particularly the excess profits tax, are proving extremely burdensome to a growth company such as Honeywell, for they make it virtually impossible to earn a reasonable return on the normal growth of the company's regular business. Under such circumstances industry
cannot provide adequate working capital and even normal improvements to plant facilities from earnings, and at the same time pay a reasonable return to its shareholders."


* * *

Instruments

"An instrument executive states,...: 'Since this tax takes away considerable cash, expenditures for capital improvements will have to be given careful consideration unless it is possible to obtain certificates of necessity.'"


* * *

Natural Gasoline

"Under the present excess profits tax law, we cannot retain enough out of earnings to amortize these obligations in any acceptable manner."

"...small, new companies...are thus unable to retain sufficient earnings to reinvest and expand to meet the demands of their normal growth."

Source: Statement of Mr. John T. Oxley, President, Texas Natural Gasoline Corp., in Hearings before the Committee on Finance, U. S. Senate, 82d Cong., 1st Sess., on Revenue Act of 1951, Part 3, pp. 1810, 1812.

* * *

Paper

"The continuation of excess profits taxes...and inflation have been very disturbing factors in the orderly planning of your company’s operations. It becomes increasingly more difficult to generate net earnings sufficient to provide funds for further expansion, and harder to maintain enough incentive to keep an organization energized."


* * *

Petroleum

"Under present conditions, retention from current income of funds needed for expansion has been made extremely difficult, if not impossible. High corporate income taxes, and particularly excess profits taxes...have, in effect, placed a ceiling on earnings...,"

* * *

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"...long range programs are in different stages of accomplishment. As they progress, capital requirements needed to carry them out will, temporarily, expand beyond the point where all of such requirements can be met from earnings. This is particularly true under present tax laws..."


* * *

Steel Forgings

"To provide for high taxes levied against business enterprise--normal, surtax and excess profits taxes--a total of $1,625,000 or 68 cents of every dollar earned before taxes had to be set aside. It is imperative to explain that being called upon to pay 68 cents out of every dollar earned to the government is stifling business. The financial ability to continue modernizing and expanding, and to undertake new ventures is an integral part of the existence of any business. Without this, industry cannot maintain earnings. Job security and investment security are impaired."


* * *

Synthetic Textiles

"First, it subjects to excess-profits tax not a relatively minor fraction of our normal profits, but roughly half of our normal profits.

"Second, by subjecting 50 percent of our normal profits to excess-profits tax, we will be seriously restricted in our efforts to maintain our research and expand the production of our products necessary to defense and to maintain competitive civilian production."

Source: Statement of Mr. Harold Boeschenstein, President, Owens-Corning Fiberglas Corp., in Hearings before the Committee on Finance, U.S. Senate, 82d Congress, 1st Sess., on Revenue Act of 1951, Part 3, p. 1593.

* * *

Watches

"...We must face the fact that as long as excess profits taxes continue at current levels the net earnings cannot in any way keep pace with other improvements in the business.

"...The ability of all businesses to retain sufficient funds after taxes to provide the necessary machinery and equipment to keep themselves up-to-date and growing has been seriously impaired.

"...The present tax rates are making it virtually impossible to increase working capital fast enough to keep up with inflation. The ultimate result may be to limit the volume of business done to the amount that working capital will finance, rather than the amount of product that can be sold to our customers."


* * *
E. EPT REPEALS OUTSIDE INVESTORS BECAUSE OF THE REDUCED PROFITS AND DIVIDENDS AVAILABLE FOR DISTRIBUTION TO STOCKHOLDERS.

General

"Although the main source of permanent capital since the war has been, fortunately, retained earnings rather than long-term debt, more than one-half of industry's operating earnings are now being taken by Federal taxes. Present rates, which run up to 62 percent on the income defined as 'excess' relative to a base period, make it difficult for most concerns either to build up equity capital or to sell new stock to investors."


* * *

Banks

"But Federal taxation -- especially the excess profits tax--bears down so severely on bank earnings that bank stocks have been selling substantially below their book values. As a result, it is increasingly difficult to attract new capital in the highly competitive investment market, except by offering stock at a price substantially less than the fair values represented in the shareholders' equity. The large banks in the financial centers are near the bottom of the scale among all the nation's major industries in the average return earned on the capital the owners have at risk. Because of the abnormally low earnings obtainable under the present tax law, they cannot build up capital funds from earnings at an adequate rate and at the same time pay satisfactory dividends.

"Many of these large banks, including the Chase, are faced under the existing laws with a tax burden so heavy as to be almost confiscatory. These are the banks with the widest ownership of their shares by small investors; moreover, these are the banks which, by virtue of size and leadership, must be relied upon as the major source of credit in the nationwide industrial expansion for rearmament.

"The earnings of an increasing number of banks are subject both to the regular Federal income taxes and to the 'excess profits' tax, which in effect is an excess tax on normal or even subnormal profits.

"Without going into detail or explaining variations in the tax law, the essential facts are as follows: That portion of bank earnings arbitrarily termed 'normal' or regular is taxed under the present Federal law at 52 percent. Additional earnings are taxed at 62 percent, representing a 52 percent regular tax and a 30 percent tax on so-called 'excess profits.' Actually, few banks had sufficiently large average earnings in the base period years to make it advantageous to use that method as one of two optional 'yearsticks' under the law for determining the excess profits tax credit. Consequently, most banks are obliged to use the alternative 'invested capital method' in computing their tax liabilities.

"The extent of the impact of Federal taxation on earnings will vary somewhat for individual banks, depending on such factors as size, rate of growth, sources of income, etc. In general, however, the present law restricts the net earnings of many large banks so drastically as to be discriminatory and
basically unsound. The fact is that under the present excess profits tax law the maximum return permitted on all invested capital (as defined in the law) above $10,000,000 is 3.84 percent before the excess profits tax applies."


* * *

Natural Gasoline

"...we have reached the saturation point so far as obtaining risk capital and bank loans is concerned. There are a number of projects available currently if it were possible to obtain financing for them.

"We originally built our plants on the basis of 38 percent tax rate, which permitted a 62 percent retention of profits for the purpose of expanding the business and paying off loans. Now under the present law we are faced with a tax rate of 62%, thereby reversing our position and allowing us to retain only 38 percent of the profits versus the originally contemplated 82 percent. This increases the length of time required to repay the loan and it is not a sufficiently encouraging picture for risk capital coming to market for the purpose of financing such projects."

Source: Statement of Mr. Louis F. Booker, Jr., Comptroller, Texas Natural Gasoline Corp., Tulsa, Okla., in Hearings before the Committee on Ways and Means, House of Representatives, 82nd Congress, 1st Sess. on Revenue Revision of 1951, p. 1215.

* * *

Steel

"A steel president cites the excess-profits tax as 'one of the factors compelling us to pay stock dividends on common stock.'"


* * *

II. THE EXCESS PROFITS TAX STRANGLES PRODUCTIVE EFFORT BY BRINGING ABOUT A TAX-ORIENTATION OF MANAGEMENT!

General

"It is apparent that during the applicability of the excess profits tax law, alert management must consider, more seriously than ever, the tax effects of proposed transactions. Intimate familiarity with the law's provisions is the only means of assuring maximum protection."

"...A dollar of earnings not subject to EPT is ordinarily worth more than twice as much as a profit dollar subject to the levy. Tax-oriented business judgment is an inevitable consequence of this disparity. Hence the tax provides a subsidy to those companies fortunate enough to have earnings reaching beyond their EPT exemptions. Such companies can do things, take risks, which their less fortunate competitors cannot so well afford to do. The advantages for the company in the EPT bracket are so favorable that expenditures (or in the alternative, voluntary reductions of income) become judicious (sometimes almost mandatory) which, without the sharp differential in real cost, would be unwise."


* * *

"The existence of income subject to excess profits taxation is an important feature. The higher the marginal tax rate, the less the net cost, from both the income and the cash standpoint, of any deductible expense. Though an outlay with no immediate or long-run benefits is wasteful at any tax rate under 100%, where some long-run benefit is likely, a high tax rate shifts all doubts and calculations of probability in favor of the expenditure. Also, the accelerated amortization provides what has come to be referred to as a rapid 'cash throw-back.' For a company not subject to the ceiling provision in the tax law, so long as the additional depreciation does not pull the corporate income below the excess profits level, every dollar of allowable deduction reduces net income by only 18 cents, under an 82% tax rate, and at the same time saves a cash outlay for taxes of 82 cents. Short-term financing thus becomes feasible for a facility which typically would require long-term bonds. A cash budget projection may be almost as significant as a projection of income and expenses in calculation on the desirability of an expansion program."

Source: Smith, Dan Throop, Effects of Taxation on Corporate Financial Policy, Boston: Harvard University Graduate School of Business Administration, 1952, p. 99.

* * *

A. EPT REMOVES THE PROFIT MOTIVE AS AN INCENTIVE TO CUT PRODUCTION COSTS, AND AVOID WASTE AND EXTRAVAGANCE, SO THAT MANAGERIAL DECISIONS ARE NOT WHOLLY BASED ON SOUND BUSINESS CONSIDERATIONS OF EFFICIENT, LOW-COST PRODUCTION.

General

"The excess-profits tax has so cheapened the dollar and increased the advantages of spending that it has struck a serious blow at sound business judgment, ...companies find themselves 'fighting the impulse to spend more freely just because the government is paying the bill."

"A laxity in expenditures is the natural consequence of high taxes when the prevailing point of view is that the government is paying most of the bill,' executives say, adding that 'it leads to extravagance, wastefulness, and uneconomic operations by permitting expenditures which would normally be considered exorbitant.' Thus 'one must guard against a possible change in the
cost mindedness of an entire organization, because of a multitude of decisions, minor in their individual effect, can seriously increase costs and create bad cost habits which will be hard to overcome."


* * *

"...That an excess-profits tax does encourage waste cannot be denied. It is only natural that when the real cost of something is but a fraction of the nominal cost, purchase of that something is encouraged. And so, in an EPT period and in the absence of effective controls...we are likely to see higher expenditures for such items as advertising, travel, and entertainment...."


* * *

"...the excess profits tax created for those companies subject to excess profits tax, a double standard of expense dollars, and...the existence of two kinds of money...force a new basis for managerial judgment affecting all phases of a business.

"Tax-orientation of management is the consequence of high marginal excess profits tax rates. Under such rates, to the extent a business is subject to excess profits taxes, management has two kinds of dollars to work with. It has cheap earned dollars and expensive earned dollars. Cheap earned dollars are those which, if not spent, will be taxed at high marginal rates; expensive dollars are those which are taxed at ordinary rates.

"Under the present excess profits tax law, the marginal rate is 77%, so the cheap earned dollar is worth 23%. The ordinary rate is 47%, so the expensive earned dollar is worth 53%--more than twice as much as the cheap dollar. If the marginal rate is increased still further, the cheap dollar will become cheaper still.

"The possibility of carelessness and waste as a result of government-induced private spending is a matter of common knowledge. What is less well understood is the fact that the existence of cheap dollars makes prudent many business activities that would not be prudent except for the fact that the dollars expended are cheap.

"The excess profits tax is therefore not a burden, but a subsidy. It provides cheap dollars to the profitable and established company, dollars which can and must be used by a responsible management to safeguard and to extend the position of such a company against competition. If a company is not in excess profits, if it is weak in earnings, or young, or with inadequate capital--in other words, if it has only expensive dollars in its arsenal, it is at a double disadvantage as against its entrenched rival with tax-created cheap dollars at its disposal.

"The battle for markets, through better products, better coverage, better inventory stocks--yes, and through better advertising and promotion,
too—will be a battle between the cheap expense dollars and expensive expense dollars, and the cheap dollars will win because they can extend farther and can take more risks.

"By reason of the excess profits tax, the government has created a double standard of dollars with favors going to those who are already strong. The excess profits tax is a veritable engine of concentration, compelling prudent and aggressive business management to use wisely its cheap dollars to entrench and to expand. With government-excess-profits-tax-cheap dollars, the big will grow bigger and the small and weak will merge with them, or die."

"...all business wants to avoid putting tax considerations before market considerations; because when this happens, competitive enterprise based on efficiency and ingenuity in serving the public’s demands and have been distorted by artificial and irrelevant factors which have nothing to do with skill in making and distributing the things and services that people want."

"in essence, what has happened is that for some companies, cheap dollars have been created which make prudent the taking of risks that would be considered doubtful if all expense dollars had the same value...."

Source: Ruml, Beardsley, Management under the Excess Profits Tax, Chicago, 1951, pp. 8-10, II.

* * *

Chemicals

"...This tax also invites inefficiency since tax savings are offered that in effect subsidize wasteful spending. Relaxation of cost consciousness is contrary to sound business principles at any time, but is particularly serious in time of national emergency, when maximum efficiency and productivity are at a premium."


* * *

"...I am seriously concerned with the impact of the present tax law, and especially the increases in the corporate excess-profits taxes that have been proposed in the new tax law.

"It is putting little fellows like myself, and other corporations that exist, as my neighbors of a smaller nature, in a bad psychological frame of mind.

"We have for years, when we built these little businesses, been as efficient and as careful and as thrifty as we can in our organization in dealing with our employees. But now our employees know that we are paying a good portion of our earnings out in income taxes; they just know that. They pretty well know what goes on, and they are becoming wasteful. It is difficult to discipline them.

"You know, the relationship between management and the employee, and they know that, for instance, my salesmen traveling out, they know and they see
competitive salesmen traveling in Buicks and Cadillacs, and so on, and my men, traveling in Chevrolets, it is just a bad psychological situation, and they are demanding those same luxuries from us because, as they put it to me, why, the Government is paying the freight, and 'We don't see why you should worry.'

"It is not that blunt, but it is a bad psychological picture that is existing among my people that I have to depend on to operate my business."

Source: Statement of Mr. Carl Wittichen, Jr., Wittichen Chemical Co., in Hearings before the Committee on Finance, U.S. Senate, 82nd Congress, 1st Sess., on Revenue Act of 1951, Part 2, pp.412-413.

* * *

Machine Tools

"A machine-tool executive...notes: 'This is a poor training ground for young executives who tend to make decisions based upon the tax situation alone, rather than on good common sense. This will lower the standards of business leadership throughout the country.' This executive adds: 'However, at the present time decisions based on the tax seem justified and the only way people can operate.'"


* * *

Smelting

"Provision...of...$900,000 was for excess profits tax...."

"It is extremely difficult for an organization to keep driving for additional sales, increased production, lower costs and greater efficiency, when its members realize that less than 18% of the results of their combined efforts may be translated into net profit after taxes...."

Source: The Eagle-Ficher Company, Annual Report for the fiscal year ended November 30, 1951, p. 3.

* * *

B. EPT ENCOURAGES CURRENT EXPENSES THAT ARE TOO SPECULATIVE UNDER ORDINARY TAX CIRCUMSTANCES.

General

"...Some executives who have dug into the problem...think real progress can be made. A typical constructive suggestion: the part of a firm's income that is subject to EPT should be carefully segregated and used only for risk programs--programs for research, perhaps or foreign investment. It should be put into ventures that normally would be passed over but that, if they click, would put the company far ahead of its competitors--ventures that would contribute substantially to the productivity of the U. S. economy."

Source: Newsweek, October 29, 1951, p. 75.

* * *
"The kind of expenditure I have in mind when I say that the EPT company enjoys an advantage consists of deductible expenditures which are productive, or at least have a reasonable chance of being productive. The company that cuts its prices in order to build up customer good will is getting something for its 18-cent dollars. It is not throwing them away. The chances are it will reap more than 18 cents benefit from the current sacrifice of these dollars. The company which offers free service or better service will in all probability gather a better return than the 18 cents per dollar that these services cost. The company that puts money into deductible research is likely to find that its gamble has paid off well. Naturally the gamble must be a good one to justify the expenditure....

"Since the companies which pay EPT are in the main the stronger and more powerful companies, the double standard of dollar values will tend to enable them by low cost research, service, and good will promotion to entrench themselves even more strongly and place their competitors at a further disadvantage."


* * *

"The inclination often is to spend money on all manner of things that can qualify as deductible 'business costs.' Companies go in for high-cost research, elaborate promotion, big parties and favors. They are encouraged to give money to colleges and charities. They find it easy to raise the pay of employees and to set up big expense accounts for executives. Some buy new equipment before it is really needed, or expand beyond immediate requirements. The urge is to spend, since Government pays most of the bill anyway."


* * *

1. EPT encourages research on questionable new products and new designs.

General

"Another field in which the disparity in dollar cost play a part is research. A number of our largest corporations have made sizable contributions to the University of Chicago’s atomic energy research program, in the hope that the research activities will develop something that will aid their respective industries. Obviously the company in the EPT bracket can better afford to contribute to such a program than a competitor not so favored. Of course, the University’s research is for noncontributors as well as contributors. But it is not unlikely that the contributor will learn of what is going on earlier than the noncontributor; nor is there anything reprehensible about this. To cite an example of individual research expenditure, I have heard of a company which, anticipating the general use of color television, is conducting a study directed to the development of harmonious color combinations for the packages in which its products are marketed."

Advertising

"...confiscatory rates of taxation on earnings, which by law are considered excess profits, made it prudent in management's opinion to spend a part of those profits for company development."


* * *

Electrical Appliances

"We are contemplating further expansion in our research program and expect to continue new-product development at an accelerated rate.' (Electrical Appliances)."


* * *

Electrical Controls

"During 1952 as well as in 1951, we have recognized the tax advantages of expenditures for product development, needed repairs and reconditioning of facilities.... While these items further reduce current profits, valuable new products and greatly improved facilities have been acquired at relatively low net cost to the Company."


* * *

Electrical Supplies

"'The tax has stimulated expenditures on research, new-product development, and advertising.' (Electrical supplies)."


* * *

2. EPT encourages unnecessarily heightened efforts for product promotion and institutional and public relations.

General

"The business gift market, now in the quarter-billion-dollar range, has been growing steadily since the wartime days of cost-plus contracts. Thanks to excess profits taxes, it is still growing...."

Source: Business Week, November 8, 1952, p. 45.

* * *
Hardware

"As our projects reach the excess-profits bracket, we will naturally be inclined to spend more money on advertising, etc. (Hardware)"


* * *

3. EPT encourages highly speculative exploration for new sources of raw materials.

Petroleum

"...a...petroleum producer...says...low-cost dollars will be devoted principally to the discovery and development of new oil fields."


* * *

4. EPT fosters increased maintenance charges for building and machinery repair.

Building Materials

"We are considering shutting down a portion of our plant when our E.P.T. credit base is reached and diverting our plant labor to maintenance, painting, etc., where practically the full benefits of their efforts can be realized without wearing out our machinery for a minimum of return. (Building Materials)"


* * *

5. EPT encourages excessive liberality toward employee benefit plans.

Automobile Equipment

"Our past-service pension cost is being funded at a higher rate than we probably would have used. (Automobile Equipment)"


* * *

Foundry

"Funding of pension plans will likely be accelerated under current tax laws. (Foundry)"


* * *
Machine Tools

"We are planning greatly increased expenditures for employee welfare, rest rooms, lunch rooms, and the like." (Machine tools)


Petroleum

"...After careful study of costs and the effect of the excess profits tax on income, the Management has established a Pension Trust..."

Source: Cosden Petroleum Corporation, Annual Report for the Fiscal Year Ended April 30, 1951, p. 3.

Railroad

"...arrangements have been made partially to fund the pension plan by cash payment to a trust. By making tax-deductible payments in high tax years the actual cost to the company of the retirement plan is reduced by tax savings. In 1951, accruals for income and excess profits taxes were reduced by $1.3 million by making a $2 million cash payment to the trustee."


C. EPT IMPELS CHARITABLE GIFTS OF STOCKHOLDERS' PROFITS AT BARGAIN PRICES.

General

"Still another item in which the disparity in cost between the EPT companies and the non-EPT companies plays a significant part is charitable contributions. Obviously, a company whose contributions cost is 18 cents on a dollar can better afford to build up good will by contributions to the local community chest or to national charities than its competitor not so favored."


Machinery

"Little Problem--Consider, for example, such a relatively simple problem as the case of the Whitin Machine Works and its gift to the town of Northbridge, Mass. Whitin is located in Northbridge, pays about 35% of the local taxes. A few weeks ago Whitin gave the town a free gift of $100,000, requiring only that it be used for 'public purposes'--presumably for expenditures that would otherwise have had to be met out of tax revenues. By this move, Whitin saves the other taxpayers in the town $65,000. And since Whitin is in an 83% tax bracket, the $100,000 outlay only costs it $20,000 in reduced net profit. Moreover, Whitin itself may save $35,000 of local taxes, which would cost it $7,000 of its own money, $28,000 of federal tax deduction.
"All in all, it looks as if Whitin has bought $65,000 worth of local good-will for $13,000.

"Maybe it has, but the company can't be sure. Next year it expects to be doing a larger proportion of military business with a lower profit return. This may leave it an excess profit credit it could carry back to 1951—so its gift may end up costing it several times as much as $13,000."


* * *

D. EPT PROMOTES UNWISE CORPORATE REORGANIZATIONS AND OTHER CHANGES IN THE CORPORATE SET-UP.

General

"...certain mergers...planned for strictly business reasons are hampered by the fact that in these particular cases a substantial loss in excess-profits tax bases will result."


* * *

"...a company whose earnings have dropped substantially below its credit and which has loss carry-overs cannot be prevented from buying up a profitable business and thus using up its credit and carry-overs. Such a purchaser can afford to pay a substantially higher price for the business than a competitor which is itself in excess-profits brackets.

"Some corporations have organized new subsidiaries to conduct their foreign operations and receive the income therefrom...."


* * *

"The reimposition of excess-profits taxation has thrown the balance of advantage away from the corporation form in many businesses."

Source: Smith, Dan Throop, Effects of Taxation, Corporate Financial Policy, Boston: Harvard University, Graduate School of Business Administration, 1952, p. 153.

* * *

"Large corporations are encouraged to buy out weaker competitors, especially if there is a record of recent losses to be inherited from the smaller firm. Losses can be carried forward as an offset to later profits."


* * *
"...bigger companies sometimes are tempted to break up into several smaller firms. Each would get a separate minimum credit against EPT, as well as the preferential regular rate that applies to the first $25,000 of annual earnings."


* * *

Containers

"...the imposition of higher corporate income taxes, the excess profits tax ... point to the desirability of further financing if the company is to take best advantage of the earning possibilities inherent in available markets, maintain its leadership in the container industry and make it possible for stockholders to enjoy the fruits of its growth and earnings possibilities.

"Under current U.S. tax laws each extra $1,000,000 of earnings instead of providing $600,000 of net for optional disposition as was the case in 1949, will now produce less than $200,000 or about 8 cents per share of common stock.

"We must assume that there will be ultimate tax relief if our national economy is to survive...."

Source: American Can Company, Annual Report to Stockholders, 1951 p. 11.  * * *

Railroad Equipment

"...a railroad-equipment firm reports that the high earnings during the base period of a company we recently acquired influenced our decision to retain the operation as a separate corporate entity rather than establish it as a division of our company."

Source: The Conference Board Business Record, September, 1951 p. 342.  * * *

III. THE EXCESS PROFITS TAX BURDENS THE ECONOMY BY CONTRIBUTING TO INFLATION!

General

"The existence of cheap...dollars in the economy, even if every one of them is prudently used, is unquestionably in some measure an inflationary influence...."

Source: Rural, Beardsley, Management under the Excess Profits Tax, Chicago, 1951, p. 21.

* * *

A. EPT EXERTS AN UPWARD PRESSURE ON PRICES.

General

"...Were it not for price controls,...a number of....manufacturers say they would raise their prices, in spite of competition, in an attempt to counteract adverse effects of the excess-profits tax..."
B. EPT STIMULATES COMPETITIVE BIDDING FOR SCARCE MANPOWER AND SCARCE MATERIALS.

General

"...What EPT actually does is to drive management away from efficiency and toward waste.

"...Big expense accounts, say the business spokesmen, are the least of EPT's ill effects. Much more important, it leads directly to labor hoarding, and the hoarding of scarce and critically needed raw materials.

"Example: a manufacturer needs machinists. He finds his competitors hiring machinists beyond their needs. He has to do the same. He foresees that if he has to have more machinists in the future, they won't be there. The tax rate under EPT is 82 percent, which means the Treasury pays 82 percent of the cost."

Source: Newsweek, October 29, 1951, pp. 74-75.

C. EPT ENCOURAGES DEBT AND DISCOURAGES THRIFT.

General

"...A corporation can reduce its excess-profits tax by borrowing money, and thus increasing its capital. A smart businessman can figure it out so that the tax saving more than offsets the interest cost. Interest is deducted from profits for tax purposes anyway. So he can make money for his company by borrowing."

"Here's another case: A corporation needs money to expand. If it sells stock, the dividends to stockholders cannot be deducted for tax purposes. But it can sell bonds and deduct the interest. So the choice is bonds, even though the company's debt may be heavy already.

"The deduction becomes all-important. The tax rate on 'excess profits' is 82 percent. Thus, if the company does manage to increase profits it realizes only 18 cents out of each dollar."


* * *

Cereal

"Our federal government takes 52 cents out of every dollar of earnings and 82 cents when the so-called excess profits tax base is reached. The government's spending and tax policies are drying up cash capital, thereby impairing new business undertakings, and forcing business, large and small, to seek additional financing or abandon plant expansion and growth."

* * *

"During the year we undertook a major program to strengthen materially our working capital position and provide funds for the future development of the business....this program involved the private placement of long-term notes and the issuance of additional shares of common stock.

"We arranged to borrow $20,000,000 from the Prudential Insurance Company of America...."


* * *

Food

"We have recently acquired additional capital through sale-lease financing and we are considering the desirability of debenture financing. Decisions in each instance are, of course, affected by the current tax law."


* * *

Industrial Machinery

"The tax makes the burden of the interest on new debt considerably lighter because of the increase in the tax base that results."


* * *
"According to an industrial - machinery president: 'If we require additional capital we will almost certainly borrow it. We would then get special tax benefits, involving a tax deduction on the interest paid and also a fairly liberal allowance of the borrowed funds as invested capital with a 12% excess-profits tax credit on such invested-capital allowance. These benefits are, of course, available to all companies.'"

Source: The Conference Board Business Record, September, 1951, p. 342

* * *

Machine Tools

"We will require bank loans of larger amounts for longer periods of time because the increased Federal taxes will drain off funds which could otherwise be left in the business to take care of increased capital needs. However, we will also increase our E.P.T. credit base by borrowing this money.' (Machine tools)"


* * *

Mail Order

"...I shall begin...with the tax advantages (for EPT companies) of borrowing money. Doubtless many of you read of the borrowing by a large mail-order company earlier this year of $200,000,000. Why did this company borrow such a huge sum? I do not know of my own knowledge what the facts were, but one does not need a crystal ball to guess that the borrowing was motivated at least in part by EPT considerations."


* * *

Petroleum

"A petroleum executive notes that if a company 'determines its E.P.T. credit on the invested-capital basis, the effect of borrowed capital will actually result in a net saving.'"


* * *

Shoe Machinery

"We had expected that we might be able to finance our working capital needs by retaining reasonable amounts of undistributed earnings. ...the extremely high corporation Federal income and excess profits taxes, have had unfavorable results not only on net earnings but also current cash. Therefore,
it may be necessary to resort to borrowing in the reasonably near future in such amounts as seem necessary from time to time..."

Source: United Shoe Machinery Corporation, Annual Report to the Stockholders, 1952, p. 10

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IV. THE EXCESS PROFITS TAX IS DIFFICULT TO ADMINISTER

A. EPT MAKES EXTENSIVE RESEARCH NECESSARY IN THE FIELDS OF ECONOMICS, BUSINESS AND RELATED SUBJECTS TO SETTLE TAX LIABILITY.

Baking

"To insure that we are receiving full advantage of the maximum excess profits tax exemption permitted, we have initiated a special study of every provision of the excess profits tax law as it applies to our business."


* * *

Electronics

"...continuing studies are being made to determine particularly with respect to the Excess Profits Tax whether or not the provisions of the law will permit the Company to pay taxes in amounts less than used in preparing the estimate...shown... At the moment, it would appear that we have selected the best base available..., but since the amounts involved are so large, the attempt will not be abandoned until it is clearly demonstrated that no better base can be found..."

Source: Hazeltine Corporation, Annual Report 1951, p. 3.

* * *

Railroads

"In this period of mounting and confiscatory taxation, we have undertaken elaborate research to discover additional legitimate means of reducing taxes by obtaining every allowable deduction. Thus have we sought to stem the dissipation of earning power from this source."


* * *

B. EPT DOES NOT PROVIDE ADEQUATE RELIEF IN HARSH CASES.

Aluminum

"The base period determined by Congress to be used in the application of the excess-profits tax is unreasonable, inequitable, and unfair as it applies to Reynolds."
"The base period fixed by Congress for determining our 'normal earnings' is precisely the period when we as newcomers to peacetime operation in the aluminum field were attempting to expand our plants, create new products, and develop new outlets for aluminum. These were the features receiving our main effort; we were anticipating normal profits in the future and were engaged in building up to reach that objective...."

... ... ...

"Reynolds had been brought to the point where it was just ready to receive the benefit from this huge expansion. It would have done so without regard to mobilization. The base period was not normal, and it is unfair to use it as the standard in determining what earnings are now to be subjected to the excess-profits tax."


* * *

Automobile Dealers

"The excess-profits-tax laws in effect from 1940 through 1945 made no general provision for the transfer of an excess-profits-tax credit based upon income (or of any part thereof) by one corporate taxpayer to another corporate taxpayer in connection with the transfer of the assets and business (or a severable portion thereof) of the former. They did, however, provide that an acquiring corporation might include in its excess-profits-tax credit based upon income, the earnings experience of the business taken over, in connection with transactions qualifying as tax-free reorganizations under section 112 of the Internal Revenue Code, under certain limiting conditions.

"The Excess Profits Tax Act of 1950 continues the general plan of the earlier acts, and a new provision covers certain transactions in which only a part of the business of the predecessor unit is taken over. Eligible transactions involving the taking over of only part of a business are restricted...."


* * *

"On...[November 1, 1952]...a series of events, including the death of one of the principal owners, I was able to purchase for myself, mostly on borrowed money, the automobile franchise in Hollywood, which I managed for the former owners for many years.

"It was, of course, something I had looked forward to all my life, as I am sure you can appreciate, and I was very happy with this new enterprise for about 2 months until I learned just how the excess-profits-tax bill, passed by the Congress, late in 1950, affected my operation.
"I was under the impression that an excess profits tax law was in effect an instrument to prevent any business from making more profit in a period of emergency such as we now have, than would be the case in normal peacetimes and I, of course, assumed that, when taking over a going business, that had been in existence for years, I would naturally take over its normal tax base that the former owners would use, were they still in business.

"You can appreciate the shock it was to me to learn that under the new law my profit base was reduced to a figure just a shade over 10 percent of what it would have been for the old owners.

"Reduced to figures, the business under my management had established a base of $247,000 for the three average years from 1946 through 1949, whereas, my present base is $30,000, which, incidentally, is less than 1 percent of my average yearly sales.

"I would like you to keep in mind that this condition exists while I am selling exactly the same products to the same customers, from the same location with the same personnel, under the same management that has existed for many years."


* * *

"...commencing with the 1st day of September 1950, I assumed the ownership of the San Diego agency, using the same assets, the same personnel, selling the same products, and generally conducting the same business in the same location, and under the same lease arrangements as its predecessor, Don Lee Motors Corp. There was no interruption of business, and Marvin K. Brown Cadillac-Oldsmobile, Inc., assumed their liabilities—such as new-and used-car warranties, service and repair warranties, time plan finance warranties, account receivable, and service contracts with customers."

"It is reasonable to assume that under the circumstances that the profits realized from the operation of this agency since September 1, 1950, are essentially the same as would have been realized from the operation of this agency, had ownership remained in Don Lee Motors Corp.

"The excess-profits-tax law, as it is presently worded, makes it impossible for this company to avail itself of the earning experience of Don Lee Motors Corp., and must instead, use the industry index rate. Thus, based upon the earnings experience of the agency during the past years, Don Lee Motors Corp., had it continued to remain in existence, would have had a base of approximately $248,000 before its earnings would be subject to excess profits taxes."
"Based upon the industry index rate, Marvin K. Brown, Inc. is entitled to earn, roughly, only $35,000, or approximately one-seventh, before the imposition of excess-profits taxes, notwithstanding the fact that it is engaged in identically the same position at the same location, using the same personnel, and assets, selling the same merchandise in the same manner as its predecessor.

"In the area in which I am situated, namely San Diego County, whose population is about 500,000, I am the only dealer out of 32 that is affected by excess-profits taxes, due to the fact that they were operating during these past years--1946 through 1948--and established their base credits...."

... ...

"I now find that I am penalized, and I am not permitted to earn as much money from the same business as the former owner would have earned, had he been able to continue to operate his own business."


* * *

Building Contractors

"Many inequities and hardships have been caused by the recently enacted excess-profits-tax law...."

... ...

"The normal practice of a general contractor is to sell a completed structure or improvement at a fixed price before it comes into existence. Generally, a purchaser requests several general contractors to bid in competition for the work. Ordinarily, the lowest responsible bidder receives the award. During the contractor's operation any increase in the cost of materials or labor, as well as other factors, is the contractor's final responsibility and generally serves to decrease the contractor's final profit. It is rare that a contractor's estimate at the time the contract is awarded is the same as when the work is completed."

... ...

"The general contractor, because of the custom of doing the work by fixed-price contract, has no means of increasing the amount called for in the contract. It was not possible to foresee the Korean conflict with its immediate increase in all types of costs going to complete the project called for by the contract. In no way can the work involved in these contracts be considered defense work or have any direct relation to the Korean conflict."
"Many general contractors hold contracts predating the Korean conflict. Many of these contracts date back several years and many will require several years to complete. Certainly any profits realized from these long-term contracts cannot possibly be considered war profits. Many of these contractors have already been penalized by the increase in the normal rates of tax now in effect. This applies particularly to the contractors that report their income from long-term contracts on a completed contract basis that is at the time the work is completed. These contractors already face substantial reduction in anticipated profits from these long-term contracts because of increased costs that have already taken effect. Many general contractors operating under long-term contracts only begin to realize their profits when the project has been under way for quite a long period of time."

Source: Statement of Mr. H. E. Foreman, Managing Director, The Associated General Contractors of America, in Hearings before the Committee on Ways and Means, House of Representatives, 82nd Congress, 1st Sess., on Revenue Revision of 1951, p. 1217.

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Cellophane

"Intelligent businessmen add products, increase capacity and make other changes after the most careful scientific, engineering, financial and business surveys. It is inconceivable that products which by happenstance added subsequent to December 31, 1949, would be denied relief when in many cases legally binding commitments and in some instances the actual facilities necessary for production might well have been in existence by December 31, 1949. It is easily seen that the resulting inequity severely penalizes tax-wise the very companies which should be encouraged because of the contribution they thereby make to the general prosperity of the country. Furthermore, it places the manufacturer of the new product in a position where it might be impossible to compete with the established manufacturer who has been making the product throughout the base period and who (assuming equal business ability) had earned the average return on investment of the entire industry."


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Chemicals

"...Excess profits taxes are an exceedingly heavy burden because of the relatively low earnings record of your company during the base period 1946 to 1949. It is indeed unfortunate that the 1950 Excess Profits Act established this period as the departure point in the computation of the excess profits tax."

"As a result of being an innocent victim of the worst industrial catastrophe in our country's history, Monsanto's net sales for the year 1947-49 averaged $150,000,000, $12,500,000 per year less than they would normally have been. Its net income before taxes averaged $26,850,000 for each of those three base period years instead of normal average net income of $33,000,000 had the disaster not occurred.

"Monsanto's excess profits tax credit based on normal base period earnings, without the devastating effect of a catastrophe like Texas City would have been $31,500,000. However, the maximum credit of which the company can be certain under the present law will be only $26,000,000, or a loss of a base of $5,500,000."

Source: Statement of Mr. Felix N. Williams, Vice President and Director, Monsanto Chemical Co., in Hearings before Committee on Finance, U. S. Senate, 82nd Congress, 1st Sess., on Revenue Act of 1951, Part 3, pp. 1655. (apparently corrected by 1951 amendments).

* * *

"...section 443 fails to take cognizance of two facts important in the chemical manufacturing industry. In the first place, based on the assumption that a normal earnings level for a new product will be attained within 3 years of introduction, it excludes new products introduced more than 3 years prior to the close of the base period. ...on the time required to bring a new chemical product to profitable manufacture....the general experience is about 7 years. The well-known writer of chemicals, Mr. William Haynes, says in his book the Chemical Front: 'The development of a new product rarely takes less than 5 years and often as long as 15 years'.

"Secondly, section 443 is unrealistic from the standpoint of the chemical industry in requiring that more than 40 percent of the taxpayer's gross income or 33 percent of its net income must be attributable to the new product within 3 years of its introduction. Chemical manufacturers generally each produce a large number of products. The number of new products produced per year by each company is relatively small, the average for 109 leading chemical manufacturers being 2-2/10 percent of the number of old products.... This being the situation, it is almost impossible for a chemical company to meet the requirements of section 443, since virtually never will one new product or group of new products introduced within the span of 3 years produce the proportional change required by the section. I seriously doubt whether Congress intended to rule out an entire industry, particularly one as dynamic as the chemical industry."


* * *

Construction

"The application of section 447 of the 1950 Federal excess-profits-tax law has resulted in very serious discrimination against construction contractors, including electrical contractors, who have started in business
immediately before or during the base period 1946-49 or since that time, or those who have suffered flood, fire, or other catastrophes or have had the misfortune to have business losses in the base period.

... ...

"In summary, these are the areas where the excess-profits-tax law works against the interests of the individual contractor, the industry, and the public:

"Industry.--The nature of the construction industry makes any attempt to apply any rate of return on invested capital lower than 45 percent unrealistic and not in accordance with the facts.

"Company.--Application of the tentative rate established for the specialty contracting industries is highly discriminatory against newly formed companies or those formed just prior or during the base period (1946-49). They have no choice between equity invested capital and historical invested capital and thus are not allowed the opportunity of selecting an equitable base.

"National defense.--Application of the present law tends to force relatively new companies to curtail or cease operations after accumulating the amount of profits permitted before the excess-profits provision is applied. This tends to slow down defense construction and possibly could have an adverse effect on the mobilization effort.

"Freedom of entry.--The nature of the present law definitely restricts freedom of entry into the construction business because it limits possible return to a point inconsistent with the amounts necessary for the acquisition of capital and capital equipment. At a time when full mobilization of construction resources is necessary, we have a law that is working very definitely in the opposite direction and is, in fact, strongly monopolistic in tendency. As such it is contrary to our national policy of full competitive enterprise."

Source: Statement of Mr. Walter R. Truland of the National Electrical Contractors Association, in Hearings, before the Committee on Finance, U.S. Senate, 82nd Congress, 1st Session, on Revenue Act of 1951, Part 3, pp. 1692, 1693, 1694. (possibly corrected by 1951 amendments).

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Glass

"Net profits after the payment of taxes...have been drastically reduced by a capricious and misnamed 'Excess Profits Tax' which restricts earnings after taxes to substantially what they were before...additional investments were made. While the need for increased Federal income is universally recognized, it need not be obtained by a system of taxation which ignores progress and makes the present like the past, by an economic concept loaded with inequities—which in our case takes 82 percent of the increase in earnings over those of an arbitrarily chosen past operating period having little resemblance to the present."

"The Allstate Insurance Co. is a stock casualty company. It was organized in 1931 and writes automobile insurance only.

"All of its stock is owned by Sears, Roebuck & Co. Continuously since its organization it has sold insurance at 15 to 20 percent below manual rates.

"By manual rates I mean those rates which are generally charged by the 107 companies that are members of the National Bureau of Casualty Underwriters.

"It had a very rapid growth in premium income during its base period, as shown below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Premium Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946</td>
<td>$15,418,000</td>
</tr>
<tr>
<td>1947</td>
<td>19,908,000</td>
</tr>
<tr>
<td>1948</td>
<td>31,694,000</td>
</tr>
<tr>
<td>1949</td>
<td>40,906,000</td>
</tr>
</tbody>
</table>

"Notwithstanding the company's growth during the base period and notwithstanding the company's assets as of the beginning of the base period were less than $20,000,000, the present Excess Profits Tax Act denies to it the benefit of the growth formula by reason of the fact that it was a member of an affiliated group having assets at the beginning of the base period of more than $20,000,000. A factual study and analysis by Alfred M. Best & Co., insurance statisticians, discloses that only eight other insurance affiliates are in the same situation. The denial of the growth formula to these nine insurance affiliated companies results in substantial hardship and inequity.

"The inequity arises in the application of section 435 of the act prescribing the method of computing a taxpayer's excess-profit credit. When the section is applied to these nine insurance affiliates, it produces the following unintended and anomalous result. It requires such companies in effect, in computing their excess-profit credits, to average their respective earnings during their periods of growth, periods when their book earnings were understated or very much less than their true earnings, and to apply such credit or average of understated earnings in future years to book earnings which are grossly overstated."

"...The effect of the State regulatory requirement upon insurance companies to write off prepaid charges and to defer 50 percent of premium income in relation to the Excess Profits Tax Act in the case of a growing company is--

"1. To understate the earnings during a period of growth. When growth occurs during the base period, the base-period earnings are therefore understated;

"2. To afford an inadequate excess-profits credit if computed under the general average earnings method;"
"3. To overstate the earnings when (a) the rate of growth is retarded, (b) growth ceases, or (c) when there is a decline in premium writings;

"4. To require under the general average earnings method the application of an understated excess profits credit to overstated earnings when growth is retarded, ceases, or when premiums decline."

"Thus, merely because our company is a subsidiary of a group having assets in excess of $20,000,000 at the beginning of the base period, the benefit of the growth formula is denied to it. This is not true with respect to any subsidiary stock fire or casualty company of the John Doe Mutual Insurance Co. or the John Doe Life Insurance Co., irrespective of the amount of their aggregate assets."

"1. The Excess Profits Tax Act, in denying the benefits of the growth formula to certain insurance affiliates, singles out in its operation a few companies and subjects them to adverse treatment. It fails in that respect to create broad classifications generally considered equitable for tax purposes.

"2. The act unfairly places insurance affiliates in the same category with noninsurance affiliates. It fails to recognize the distinct difference between such affiliates arising out of the insurance State regulatory requirements requiring, in the case of insurance companies, the immediate write-off of prepaid charges and the deferment of substantial portions of income.

"3. The act, in relegating an insurance affiliate such as our company to the 'general average earnings' method in computing its excess-profit credit, results in requiring the use of a grossly inadequate credit and in substantial hardship and inequity.

"4. The act imposes upon stock fire and casualty affiliates not owned by mutual or life insurance companies discriminatory treatment—treatment wholly different than that applied to a stock fire or casualty insurance affiliates of mutual or life insurance companies."


* * *

Newspaper

"The Problem which I present has to do with two or more corporations which consolidated a majority of their operational facilities after December 31, 1946, and prior to July 1, 1950."
"Unless relief is given to the corporations, they will be subjected to an excessive and discriminatory tax not in keeping with the original declared purpose of excess profits tax provisions, which was to prevent the accumulation of excessive wartime profits."

[...]

"The consolidation was brought about primarily in order to effect savings in operation which had become essential by reason of the gradually increasing cost of operation caused by increases in wages, increases in the cost of newprint and other items which enter into the publication of newspapers.

"The consolidation...has resulted in substantial savings to each newspaper, and these savings are gradually being reflected in increased profits.

"By reason of the fact that the consolidation occurred in 1950, the Excess Profits Tax Act of 1950 contains no provisions under which relief could be granted either of the newspapers by reason of these increased savings, and if these corporate corporations are to obtain the relief which they are clearly entitled to, it must be by an amendment to the act which will recognize such special situations."


* * *

Paper

"With the margin before taxes on income becoming smaller we feel more than ever the unfair effects of the excess profits tax, which treats as excess profits both a part of the normal profit from the products of those facilities which were in existence in 1946, the beginning of the base period, and almost the entire proceeds of the output resulting from our building program which only came into production at or near the end of the base period in 1949."

Source: Kimberly-Clark Corporation, Annual Report, year ended April 30, 1952, p. 3.

* * *

Real Estate

"In general the base period was a prosperous period for corporations. Certain corporations and certain industries, however, could not take advantage of the prosperity of the base period and Congress, accordingly, has prescribed in the act relief for those corporations and industries such as, for example, regulated public utilities the income of which was subject to governmental limitation. Such relief, however, has not been extended to real-estate corporations owning and operating office buildings and multiple dwellings the earnings of which were restricted by limitations in the form of rent controls."
"Federal rent controls were originally introduced by the Emergency Price Control Act of 1942 administered by the Office of Price Administration. The present controls are based on the Housing and Rent Act of 1947 as amended. Under the latter act controls were removed in many parts of the country during the base period but in others they were continued...."


"...the present excess profits tax law and also the revision contained in the proposed tax bill have not given due consideration to the penalty which is inflicted on corporations recently out of reorganization which have neither three years of representative earnings during the base period 1946 to 1949 nor an adequate capital base from which a reasonable excess profits tax credit would result.

"In these unusual times it would seem no more than appropriate that some fair formula be developed for corporations recently out of reorganization which will result not only in a fair return to stockholders but will also permit the building up of reserves in prosperous times to provide a cushion for less favorable years for it has been on this basis of fair returns and reserves for contingencies that American industry was founded and has survived."


"...the management has felt that the excess profits tax laws do not give due consideration to the penalty which is inflicted on real estate corporations, the earnings of which have been adversely affected by controls in effect during the base period 1946 to 1949...."


Rubber Products

"We are an aggressive medium-sized company that decided to enter the 'Foil Rubber' field in spite of the foothold obtained by the major companies and the financial resources at their disposal. Unhappily, we made this decision in 1945 and introduced our new product and increased our capacity and facilities in 1946. I say unhappily because if we had entered the field and had increased our capacity a year later, we would now be entitled to qualify under the relief provisions of the Excess Profits Tax Act."

...
"Section 443 and 444 is aimed at our type of situation but fails to hit us because the 'new product' or 'change in capacity' must have occurred in the last three years of the base period.

"...this draws an arbitrary line that is economically unsound. It presupposes that a company which enters a new field and increases its capacity accordingly, in the year 1945-46 realizes sizeable earnings therefrom almost immediately and that this new product potential and expansion is adequately reflected in base period earnings. It just doesn't work that way!"


Shoes

"Another fact which provides a basis for measuring the present federal tax bite is this. Our Company must pay 'excess profits' taxes at practically confiscatory rates on over $3,000,000 of its $20,321,019 income in 1950 despite the fact that this is less than its earnings of $22,593,779 in 1947 and $22,008,601 in 1948, two years which are considered reasonably normal years."


Shrimp Peeling Machines

"In the case of Peelers, Inc., the result obtained has the color of absurdity. Having created a new industry, the corporation falls within no well-defined classification but is lumped into a catch-all classification entitled 'Miscellaneous Business Services' for which the Secretary of the Treasury has proclaimed a tentative rate of return of 13.3 percent.

"The corporation earned over $150,000 during the year 1950 on a combined invested and borrowed capital of $174,000, an actual return of over 85 percent. To apply a normal rate of 13.3 percent is manifestly unrealistic.

"In view of the inadequacy of the industry rate of return in this instance, the corporation is subject to the ceiling tax...in spite of the fact that none of its income represents war or inflation earnings. Handsome as the corporation's profits are, the shareholders are faced with the prospect of retaining only 30 cents out of every dollar earned. After providing for
repayment of borrowed capital (which it is obligated to repay within 10 years) and for the future expansion of its operations, little or nothing of this 30 cents will remain for distribution as dividends. Yet, since the income-producing factor of the business is patent protection, the shareholders must make their profit during the limited life of the patents. Unless relief is forthcoming, the shareholders' profit will be small indeed.

"Faced with this situation the shareholders of the corporation must either obtain prompt and complete statutory relief or liquidate the corporation and operate as a partnership, thus avoiding all corporate taxes."


* * *

Sulphur

"The nonmetallic mines are now in a worse position than they were under the World War II law, for under the old law there was some possibility of relief under sections 721 and 722. Under the present law the failure to grant relief to nonmetallic mines in subparagraph (b) (4) of section 453 results in taxing the normal profit of new nonmetallic mines, a distinctly discriminatory treatment not only between industries but also against new mines in the same industry.

"For such urgently needed minerals as sulphur and potash it would seem fair and equitable, as well as in the national interest, to provide the producers of sulphur and potash with 'this greater incentive for the opening up of new properties' and in order to place them in a 'similar tax position with competitive properties in operation during the base period.'"

Source: Statement of Mr. Eugene German, Vice President and Treasurer, Duval Sulphur and Potash Co., Houston, Texas, in Hearings before the Committee on Finance, U.S. Senate, 82nd Congress, 1st Sess., on Revenue Act of 1951, Part 3, p. 1646. (apparently corrected by 1951 amendments).

* * *

Synthetic Textiles

"Without additional relief my company will not only pay excess-profits taxes on all earnings attributable to the defense program, but on 50 percent of our normal peacetime earnings as well.

"This unfair taxation of normal profits comes about because our excess-profits-tax credit under the most favorable of the relief provisions will be only $6 million, although our normal level of earnings at the end of the base period was $12 million per annum.

"This wide discrepancy between our excess-profits-tax credit and our normal earnings level results because the present act does not give adequate recognition to extraordinary growth."
"During the base period, 1946 to 1949, we quadrupled our investment in plant, doubled our productive capacity, doubled our sales, and increased our earnings more than tenfold."

The Korean War and accelerated defense needs had nothing whatever to do with these facts.

"During 1946 to 1950, our growth in plant was twice that of our eight principal competitors and 3 times that of manufacturing corporations in general. Our increase in sales was 2½ times those of all manufacturing corporations.

"But after taxes, we were permitted to keep, in 1950, 18 percent less of our net income than the average for all manufacturers.

"As the impact of the excess-profits-tax increases in 1951 and subsequent years, this spread will become even greater."


* * *

Televison Broadcasters

"...television broadcasting is a new and pioneer industry. During the base period years for which average earnings credit is computed under the excess-profits tax law--1946 to 1949 inclusive--television broadcasting was pioneering and experimenting. Practically every station had a red-ink base--a rather dubious distinction, to be sure, but true. Starting with 8 stations in 1946 the number on the air grew to 97 by the end of 1949.

"In 1948 the 50 stations on the air lost $15,000,000. The exact figure is $14,900,000 and some-odd... In 1949 the 97 stations on the air lost $25,100,000. Their original investment for plant and equipment was $55,900,000...."

* * *

"Under the excess-profits tax law you have taken our earnings by a tax on what obviously are not war profits. You have given us a rate of 62 percent, that is to say the ceiling rate...."

"Where are we going to get the money to pay our bank loans and our other debts? Where are we going to get money to renew our equipment?

"We have the uncertainty and confusion attending upon the development of color television.

"There are some existing stations that are far from out of the woods financially. We have got to have additional capital to carry on. Color will
perhaps produce additional losses for us until there are enough receivers in the hands of the public to make color programs profitable to the advertisers.

"Even now, anticipated limitations upon the production of black and white television receivers can and probably will drastically delay the development of that circulation which television broadcasting stations need in order to operate profitably.

"...how are we going to keep our stations on the air with improved equipment to which you, as viewers, are entitled, if we are forced to pay 70 percent of our earnings to the Federal tax collectors, and other larger corporations pay only 50 or 55 percent, or whatever rate you gentlemen decide upon. Do we as a group who have taken these huge hazards, deserve to be penalized for our willingness to experiment and bring to you this modern art of television?

"...in the confusion of so quickly enacting an excess-profits tax law no formula was brought forth that could give adequate recognition to the problem of the broadcasters, both those who have radio and television stations and those who only operate television stations."


* * *

"The impact of losses from television upon those radio broadcasters who undertook television activities was such that it depressed base-period normal earnings from radio, so as to leave us in the position today that roughly 50 percent of all of our normal earnings derived from radio are now taxed, under the excess-profits tax, and 100 percent of our earnings, present and future, in television will similarly be taxed under the act.

"In other words, the credit which we have before the imposition of the excess-profits tax is representative of only the loss experience we sustained in television."

Source: Statement of Mr. John B. Poole, Television Broadcasters Tax Committee, in Hearings before the Committee on Finance, U.S. Senate, 82nd Congress, 1st Sess., 1951, on Revenue Act of 1951, p. 1772. (apparently corrected by 1951 amendments).

* * *

Welding Equipment

"Morton Gregory Corp. was incorporated in January 1948. Its principal business is the manufacture and sale of stud-welding guns, control mechanisms, parts and studs....

"Morton Gregory Corp. acquired its stud-welding business in 1948 from the patentee, Ted Nelson, for $484,100 plus 21/2 percent of the gross

-45-
income received from the business for 12 years with a minimum annual guarantee of $25,000. The $484,100 covered inventories, plant, and equipment, while the 21\% of the gross income covered patents, patent applications, trademarks and inventions."

"Under the Excess Profits Tax Act of 1950 Morton Gregory Corp. will be required to pay taxes at the maximum rate prescribed under the act on profits which are substantially normal in that these earnings were anticipated as peacetime results from the commercial development program pursued by the company in the years 1948, 1949, 1950.

"The Act attempts to provide for relief in cases such as this by allowing the taxpayer to use as a credit an amount based upon what is supposed to be a fair return on the 'adjusted basis' of its assets as of the first day of its first excess-profits-tax year. The inequity of any such method of providing relief in the case of Morton Gregory Corp., however, is due to two very salient facts, namely:

1. Its most valuable asset (its patents), for, which it has paid and will pay very substantial amounts, does not have an 'adjusted basis,' as defined by the Internal Revenue Code, which reflects the entire amount which has been paid and will be paid for these patents, and

2. The fair rate of return on its assets, as provided by the existing statute, is not in anywise indicative of a reasonable rate of return for a corporation in a business such as that engaged in by Morton Gregory Corp."

Source: Statement submitted by Morton Gregory Corp., Lorain, Ohio, in Hearings before the Committee on Finance, U.S. Senate, 82nd Congress, 1st Sess., on Revenue Act of 1951, Part 3, pp. 1784-1785. *(substantially corrected by 1951 amendments).*

**Wholesale Merchandise Distributors**

"...in a very real sense, the Excess Profits Tax Act places a heavy penalty on the success of our efforts to improve our company's earning power. The requirement under this Act to measure our company's 'normal' earning power by results achieved during a base period marked by operating losses, makes no allowance for and subjects to unfair taxation the improvement in earnings achieved primarily through the reduction of costs."

Source: Butler Brothers, Annual Report for the year ended December thirty-first 1951, p. 11.

**"The high operating costs and fixed expenses that stemmed from the expansion program...coupled with loss of volume and precipitous markdowns on merchandise, developed large losses beginning almost immediately in 1947."**
"New management was brought into the company about mid-1947 to stop these losses and to develop improved earning power. However, in the three following years 1947-49, the company showed taxable net losses of almost $5,500,000. Excluding a profit of $900,000 on the sale of real properties, the loss from operations during this 3-year period was nearly $6,500,000.

"About the middle of 1949 the company's top management was changed again. With this change, substantially every one of the company's top executives had been replaced since mid-1947."

...Butler Bros. has no normal pattern of past earnings that can be used as the basis of measuring excess profits for the purpose of equitable taxation within the spirit of the 1950 act.

"Under the Excess Profits Tax Act of 1950 the efforts of the company's management and board of directors to restore the company's earning power sufficiently to permit it to remain in business, and to perform a needed service to independent retail merchants, will be penalized for their success.

"The 'average earnings' method of computing the excess-profits tax credit, based on earnings in the base period years 1946-49, is clearly inapplicable to the company.

"The alternative offered by the Excess Profits Tax Act of 1950 of computing the excess-profits-tax credit by formula related to invested capital also is clearly inapplicable, and inequitable if applied to the company.

"Through consultation it appears that the act as written, and the regulations issued by the Commissioner of Internal Revenue, do not afford the company direct access to a suitable relief provision. It did not experience the substantial change in products or services apparently required by section 443 to apply for relief thereunder. There was no such increase in capacity or production as contemplated by section 444. It is not a new corporation as defined by section 445. The wholesale industry is not one of the depressed industries determined by the Secretary of the Treasury under the provisions of section 446. Relief sections 448, 449, 450, 453, 455, are specific industry relief provisions and as such inapplicable to the company. Section 442 (a) (1) does not apply and the World War II Excess Profits Tax Act decisions relating to the relief provided by section 442 (a) (2) indicate that by interpretation, this section does not apply to the circumstances in the company's experience.

"The foreclosure of the company's access to suitable relief provisions of the Excess Profits Tax Act of 1950 imposes an unjust and inequitable tax burden on the company.


* * *
C. **EPT GREATLY INCREASES THE ACCOUNTING BURDEN, CONTROVERSY, LITIGATION, AND THE COST OF COMPLIANCE WITH TAXES.**

**General**

"The possibility of increasing net income by borrowing funds even if they are left completely idle is an altogether perverse feature of the tax laws. The law limits the allowance for borrowed capital to indebtedness 'incurred in good faith for purposes of the business' (Section 439(b)(1)), injecting difficult problems of determination of intent and purpose into the administration of the law. Comparable provisions existed in the excess profits tax in World War II concerning borrowed capital, but at that time no allowance was made for increases in the tax base because of borrowed capital for companies using the average earnings option. The present provision offers the prospect of extensive abuse and litigation, of the sort which is perhaps inevitable under a long-continued excess profits tax..."

Source: Smith, Dan Throop, *Effects of Taxation, Corporate Financial Policy*, Boston: Harvard University, Graduate School of Business Administration, 1952, p. 29.

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**Food**

"...the corporation with a fiscal year which ends after April 1, 1950, is penalized in computing the base-period excess profits net income as compared to taxpayers on a calendar year or fiscal year ending before April 1.

"...the taxpayer whose fiscal year ends after April 1 is not treated equitably...."

* * *

"...a corporation with a fiscal year which ends on March 31 has an advantage over calendar year corporations. This corporation does not include in base period income any of the low earnings for the first calendar quarter of 1946 and in addition is permitted to use the higher earnings of the first calendar quarter of 1950.

"The corporation with the fiscal year which ends on June 30 is therefore at a disadvantage to the calendar year corporation and is, at an even greater disadvantage to the corporation whose fiscal year ends on March 31...."


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