Reexamining the Federal Corporation Income Tax

January 1958

TAX FOUNDATION, INC.

30 Rockefeller Plaza, New York 20, New York
FOREWORD

This is the third in a series of studies reviewing major areas of Federal taxation. The first, Federal Excise Taxes, was published in 1956 and the second, Are High Surtax Rates Worthwhile?, in 1957.

The purpose of this study is to examine the major issues involved in recent proposals for modification of the corporate rate structure, and to consider whether these changes are desirable.

Questions of tax policy and structure have particular significance at this time because new demands for defense spending for missiles and other weapons virtually insure that Federal expenditures will remain at high levels indefinitely. This makes it essential that our tax system be designed for the long term, with the least possible weakening effect on our national economy.

Chapter I of this study backgrounds the present corporate income tax situation and summarizes the conclusions. Evidence for the conclusions is laid out in Chapter II, which deals in detail with the issues involved in recent proposals, and in Chapter III, which covers the issue of rate revision versus a general reduction in the corporation tax.

This study was prepared by the Research Department of Tax Foundation. In charge of this project was George A. Bishop, Senior Researcher. The Foundation, a non-profit organization, is engaged in research and public education on all aspects of government spending and taxation. Its purpose is to aid in the development of more efficient government at less cost to the taxpayer. It also serves as national information agency for organized taxpayer research groups throughout the country.

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I. INTRODUCTION AND SUMMARY

From its inception in 1909, the corporation income tax (called an excise tax, 1909-1912) has climbed almost steadily upward. The rate was 1 percent 1909-1915. It was raised to 12 percent in 1918, and during the 1920's it was not significantly reduced. In 1929 the rate was 11 percent. Thereafter the rate was raised by successive steps to 19 percent in 1939 and 40 percent in 1942. For the period 1946-1949 the rate was 38 percent. During the Korean War the general rate of the tax was raised to 52 percent, at which level it has remained ever since (Chart 1).

The total tax liabilities of corporations were significantly affected by the excess profits taxes of World War I, World War II and the Korean War. There was also a small capital stock tax 1916-1925, and a capital stock and declared value excess-profits tax 1932-1945. In 1936-39 there was a short-lived experiment with an undistributed profits tax on corporations.

Current proposals for modification of the corporation income tax relate mainly to its rate structure. A survey of bills relating to the corporation income tax, introduced

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Chart 1

FEDERAL CORPORATION INCOME TAX RATES

Calendar Years 1913-1956

<table>
<thead>
<tr>
<th>Percent</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>55</td>
<td>50</td>
<td>45</td>
<td>40</td>
<td>35</td>
<td>30</td>
</tr>
<tr>
<td>1913</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1915</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>1920</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>1925</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>1930</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>1940</td>
<td>30</td>
<td>30</td>
<td>30</td>
<td>30</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>1945</td>
<td>35</td>
<td>35</td>
<td>35</td>
<td>35</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>1950</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>1955</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>45</td>
</tr>
</tbody>
</table>

Source: Treasury Department.
in the first session of the 85th Congress (1957), indicated that the majority of them contained proposals for changing the relation between the normal tax and surtax rates and for raising the exemption from the surtax. Less numerous, but perhaps more widely discussed, were proposals for a progressive structure of corporation income tax rates.

The majority of the proposals were designed as measures to relieve the tax burden on small business. Some were designed as measures to check the growth of business concentration.

This study examines the major issues involved in recent proposals for modification of the corporate rate structure, and considers the question of whether any substantial modification is called for in the structure of this tax.

It is shown in Section B of Chapter II that a progressive corporation income tax would not improve the equity of the tax system. To the extent that the burden of such a tax falls on stockholders, it would hit heavily the growing number of stockholders in the middle and lower income groups who own stock in large corporations. To the extent that the burden of such a tax is shifted forward to consumers, a progressive corporation tax would, paradoxically, be a regressive tax—it would fall more heavily on middle and lower income groups than do present Federal excise taxes.

Thus a progressive corporation income tax cannot be justified on the principle of ability to pay, for its burden is not related to the size of the incomes of the individuals concerned.

Even if the corporation tax is regarded as an excise or special benefits tax on corporations as such, no basis for progression can be found. The benefits of government services to corporations are not related to a corporation's net income—profitless corporations also receive these benefits.

In section C of Chapter II the question is considered of modifying the corporation tax as a means of relieving the tax burdens of small business. It is shown that the present surtax exemption serves to mitigate the burden of the present tax on small corporations. It is also shown that further relief from the burden of the corporation tax would do little to meet the difficulties of small business in general. The vast majority of small businesses are not incorporated, and their problems are not primarily due to high taxes. It is not evident that special tax relief is an appropriate means for dealing with the peculiar difficulties of small business.

Nevertheless, it is evident that the normal tax rate of 30 percent, the only part of the tax to which about four-fifths of taxable corporations are subject, is relatively high. It is a Korean War rate, the reduction of which has been postponed for four successive years.

In section D of Chapter II the question is considered whether a progressive corporation tax is needed as a means of checking the growth of business concentration and monopoly power. It is shown that the significance of the recent "wave of mergers" has probably been exaggerated, and that, in any case, there are more appropriate means of distinguishing and dealing with positions of monopoly power.

In general, tax provisions for non-revenue purposes are suspect because they put additional burdens on the revenue system, and make it more difficult to maintain equity and to minimize the system's distorting effects.

In Chapter III the possibilities for a revision of the rate structure are reviewed and compared with the advantages of a general reduction in the corporation tax. The alternatives of an increase in the surtax exemption and of a change in the relative size of the normal tax and surtax rates are considered.

It is concluded that when substantial tax revision and reduction become possible, the change most needed in the corporation income tax is a reduction in the normal tax rate. A reduction in the normal tax rate would be of more importance to the economy than any modification of the tax for special purposes. It would be relatively favorable to small corporations; it would reduce the marginal rate on additional income for growing concerns; it would add to the sources of funds for investment; it would lower the total tax rate on all corporations and so mitigate the distorting effects of the present rate on business decisions.
II. RECENT PROPOSALS TO CHANGE THE CORPORATE TAX STRUCTURE

A. MAJOR ISSUES INVOLVED

A variety of proposals were made in the first session of the 85th Congress for substantial modification of the present corporate rate structure. The most extreme was a proposal, H.R. 7 introduced by Rep. Wright Patman (Tex.), for a steeply progressive corporation tax paralleling the individual income tax—with rates rising from 22 percent on the first $100,000 of net income to 75 percent of net income in excess of $1 billion. Another measure, S. 352 introduced by Sen. John Sparkman (Ala.), proposed a graduated set of rates ranging from 5 percent on the first $5,000 of taxable income to 55 percent on taxable income in excess of $100,000. A third proposal, S. 150 introduced by Sen. J. W. Fullbright (Ark.), was to interchange the normal tax and the surtax rates, i.e. to make the normal tax rate on all net income 22 percent and the surtax rate on net income in excess of $25,000, 31 percent (raised from the 30 percent of the present normal tax to avoid revenue loss). There were also various proposals to raise the surtax exemption.

On July 15, 1957, President Eisenhower in a letter to the chairman of the House Committee on Ways and Means, recommended several tax changes favorable to small business along the lines of the recommendations contained in an August 1956 report of the President's Cabinet Committee on Small Business. However, he opposed a rate reduction for the time being—the Cabinet Committee had recommended a rate on the first $25,000 of net income be reduced from 30 percent to 20 percent (but leaving unchanged the tax on income in excess of $25,000).

The avowed intent of most of these proposals for revision of the corporation income tax was to mitigate the tax burden on small business. There has been much discussion of the position of small business and of various Federal policies affecting small business. The fact that the great majority of small businesses are unincorporated means that corporate tax changes would not affect most small business, even if it be assumed that taxes are the key to the problems of small business.

In addition to giving tax relief to small business, proposals for a progressive corporation tax are in some cases intended to be a means of checking the growth of business concentration. This raises important policy questions about the use of tax measures to prevent monopoly and promote competition.

Thus, current proposals to revise the corporation tax structure involve three main issues: (1) the issue of progressivity in the rate structure, (2) the tax problems and tax treatment of small business, and (3) the use of tax measures to check concentration and promote competition.

B. PROGRESSION IN THE CORPORATION INCOME TAX

Apart from its non-revenue purposes, the proposal for a progressive corporation income tax raises primarily the question of equity in the distribution of the burden of this tax. The corporation tax may be regarded as an indirect tax on stockholders and consumers or as an excise or “special benefits” tax on corporate enterprise as such. But from neither point of view can convincing grounds be found for a progressive rate structure.

1. Progression and Equity Among Stockholders

It has been said that “if it is fair and just to have graduated tax rates on individual income, then it is equally fair and just to have graduated rates on corporate incomes.” This statement ignores the fact that a small corporation may be owned by a few people whose individual incomes are very large, and, on the other hand, that a large corporation may be owned by several hundred thousand people most of whose incomes cannot be large. There is no reason to put a heavier tax burden on a man because he happens to own stock in the American Telephone and Telegraph Company rather than in a small corporation.

The 1956 Census of Shareowners (New York Stock Exchange) showed that about 64 percent of all shareowners had incomes of less than $7,500 (Table 1). In 1956, six of the largest corporations each had 250,000 or more stockholders, and five had more stockholders than employees (Table 2).

Surveys by large corporations have shown the relatively small proportion of their stockholders who are in the higher income groups. A survey of its stockholders in 1952 indicated to the U.S. Steel Corporation that 74 percent of its stockholders, accounting for 53 percent of...
the shares held by individuals, had incomes under $10,000. (Table 3). A 1956 survey of individual stockholders in the Ford Motor Company showed that 52 percent had incomes of less than $10,000 and 31 percent had incomes of less than $7,500 (Table 4).

The greatest amount of dividends, as shown by Table 5 below, is received by spending units with incomes of more than $10,000. (A spending unit consists of all persons related by blood, marriage or adoption who live together and pool their income for major expenses; for this reason the percentages in Column (2) of Table 5 are not comparable with data derived directly from individual income tax returns.)

In considering equity among stockholders, however, the important fact not to be overlooked is the large number of stockholders at middle and low income levels. A progressive corporation income tax, insofar as it falls on stockholders, would bear no relation to the size of the income of the individuals concerned. A high rate on large corporations would fall heavily on people at middle and lower income levels who own stock in large corporations. A low rate on small corporations would fall lightly on wealthy individuals who own stock in such corporations.

Table 2
NUMBER OF STOCKHOLDERS AND EMPLOYEES IN SIX OF THE LARGEST CORPORATIONS IN THE UNITED STATES, 1956

<table>
<thead>
<tr>
<th>Company</th>
<th>Stockholders</th>
<th>Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Telephone and Telegraph</td>
<td>1,492,297</td>
<td>768,174</td>
</tr>
<tr>
<td>General Motors</td>
<td>629,000</td>
<td>599,243</td>
</tr>
<tr>
<td>Standard Oil (N. J.)</td>
<td>403,265</td>
<td>155,520</td>
</tr>
<tr>
<td>Ford Motor</td>
<td>300,000</td>
<td>178,051</td>
</tr>
<tr>
<td>U. S. Steel</td>
<td>287,997</td>
<td>260,646</td>
</tr>
<tr>
<td>General Electric</td>
<td>366,524</td>
<td>280,497</td>
</tr>
</tbody>
</table>


The amount of dividends involved for middle and lower income groups has increased in recent years with relatively increased institutional holdings of corporate stock. Thus participation in corporate pension plans has become very widespread. The book value of common stock holdings of these funds increased more than three and one-half times from 1951 to 1955. At the end of 1955 the assets of these funds included common stocks with a market value of $4.8 billion.²

Far from improving the equity of the tax system, a progressive corporation tax falling on stockholders would mean more inequities among individuals.

Table 3
PERCENTAGE DISTRIBUTION OF INDIVIDUAL STOCKHOLDERS AND SHARES HELD BY INCOME CLASS, UNITED STATES STEEL CORPORATION, 1952

<table>
<thead>
<tr>
<th>Income Class</th>
<th>Stockholders</th>
<th>Shares Held</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percent in Each Class</td>
<td>Cumulative Percentage</td>
</tr>
<tr>
<td>(Thousands)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under $1</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>$1-2</td>
<td>8</td>
<td>14</td>
</tr>
<tr>
<td>$2-3</td>
<td>17</td>
<td>31</td>
</tr>
<tr>
<td>$3-4</td>
<td>16</td>
<td>47</td>
</tr>
<tr>
<td>$4-5</td>
<td>9</td>
<td>56</td>
</tr>
<tr>
<td>$5-6</td>
<td>6</td>
<td>62</td>
</tr>
<tr>
<td>$6-7</td>
<td>5</td>
<td>67</td>
</tr>
<tr>
<td>$7-8</td>
<td>3</td>
<td>70</td>
</tr>
<tr>
<td>$8-9</td>
<td>2</td>
<td>72</td>
</tr>
<tr>
<td>$9-10</td>
<td>2</td>
<td>74</td>
</tr>
<tr>
<td>10-25</td>
<td>16</td>
<td>90</td>
</tr>
<tr>
<td>25 and over</td>
<td>10</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: United States Steel Corporation.

2. Progression and the Shifted Portion of the Corporation Income Tax

If it is assumed that the corporation income tax is shifted forward to consumers, there is no more ground for progression than if the burden is assumed to be borne by stockholders. Unfortunately, it is difficult to determine the precise extent of shifting, but it is believed to be substantial.

Distribution of the Burden of the Shifted Part of the Corporation Tax

To the extent that the corporation income tax is shifted forward to consumers, the burden of this tax is distributed among income groups in somewhat the same manner as the burden of excise taxes. In a recent study of the distribution of the total tax burden, Professor R. A.

musgrave distributed the shifted portion (one-third in his study) of the corporation tax among income groups on exactly the same basis as the burden of excise taxes, namely the distribution of total consumer expenditures by income classes. Since total consumer expenditures are a smaller percentage of income for high income families than for middle and lower income families, the burden of any tax allocated on this basis appears to be regressive.

In fact, excises are not levied on all consumer expenditures. Since there is some attempt to avoid taxing "necessities," the burden of excises is less regressive.

Table 4
PERCENTAGE DISTRIBUTION OF INDIVIDUAL STOCKHOLDERS BY INCOME CLASS, FORD MOTOR COMPANY
1956

<table>
<thead>
<tr>
<th>Income Class (Thousands)</th>
<th>Percentage of Stockholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $ 2</td>
<td>3</td>
</tr>
<tr>
<td>$ 2 - 3</td>
<td>8</td>
</tr>
<tr>
<td>5 - 7.5</td>
<td>20</td>
</tr>
<tr>
<td>7.5 - 10</td>
<td>21</td>
</tr>
<tr>
<td>10 - 15</td>
<td>25</td>
</tr>
<tr>
<td>15 and over</td>
<td>26</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

Median Household Income: $7,900

Source: Ford Motor Company.

Table 5 shows the distribution of the burden of the corporation income tax when it is allocated among income classes on the basis of four different assumptions on the extent of shifting: (1) that the tax falls entirely on consumers, (2) that the tax falls entirely on stockholders, (3) that half of the tax falls on consumers and half on stockholders, and (4) that one-third of the tax falls on consumers and two-thirds on stockholders. The portions of the tax assumed to fall on consumers were allocated among income classes according to the percentage distribution of total consumer expenditures by income classes (Col. 1); the portions assumed to fall on stockholders are a broader concept. The table shows the percentage of total consumer expenditures for each income class that would be allocated to income levels at various percentages of total consumer expenditures.

Effect of Degree of Shifting on the Distribution of the Burden of the Corporation Income Tax

Table 5 shows the distribution of the burden of the corporation income tax when it is allocated among income classes on the basis of four different assumptions on the extent of shifting: (1) that the tax falls entirely on consumers, (2) that the tax falls entirely on stockholders, (3) that half of the tax falls on consumers and half on stockholders, and (4) that one-third of the tax falls on consumers and two-thirds on stockholders. The portions of the tax assumed to fall on consumers were allocated among income classes according to the percentage distribution of total consumer expenditures by income classes (Col. 1); the portions assumed to fall on stockholders are a broader concept. The table shows the percentage of total consumer expenditures for each income class that would be allocated to income levels at various percentages of total consumer expenditures.

Table 5
ESTIMATED DISTRIBUTION OF CORPORATION INCOME TAX BURDEN ON SPENDING UNITS* BY INCOME CLASS* ON SELECTED SHIFTING ASSUMPTIONS
1954

<table>
<thead>
<tr>
<th>Spending Unit Income Class (Thousands)</th>
<th>Percentage Distribution of Consumer Expenditures</th>
<th>Percentage Distribution of Dividends</th>
<th>Percentage of Allocated Tax to Income of Spending Units With</th>
<th>Total Tax Allocated on Basis of Consumer Expenditures</th>
<th>Total Tax Allocated on Basis of Dividends</th>
<th>Half of Tax Allocated on Consumer Expenditures and Half on Dividends</th>
<th>One Third of Tax Allocated on Consumer Expenditures and Two-Thirds on Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $ 2</td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
<td></td>
</tr>
<tr>
<td>$ 2 - 3</td>
<td>8.2</td>
<td>.9</td>
<td>8.0</td>
<td>.9</td>
<td>4.4</td>
<td>3.2</td>
<td></td>
</tr>
<tr>
<td>3 - 4</td>
<td>9.8</td>
<td>1.9</td>
<td>7.3</td>
<td>1.4</td>
<td>4.4</td>
<td>3.4</td>
<td></td>
</tr>
<tr>
<td>4 - 5</td>
<td>14.4</td>
<td>2.3</td>
<td>6.7</td>
<td>1.1</td>
<td>3.9</td>
<td>3.0</td>
<td></td>
</tr>
<tr>
<td>5 - 7.5</td>
<td>14.8</td>
<td>2.8</td>
<td>6.4</td>
<td>1.2</td>
<td>3.9</td>
<td>2.9</td>
<td></td>
</tr>
<tr>
<td>7.5 - 10</td>
<td>28.2</td>
<td>8.4</td>
<td>6.2</td>
<td>1.8</td>
<td>4.0</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>10 and over</td>
<td>10.3</td>
<td>5.2</td>
<td>5.7</td>
<td>2.8</td>
<td>4.3</td>
<td>2.7</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>78.4</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Note: A spending unit consists of all persons related by blood, marriage or adoption who live together and pool their income for major expenses.

* Money income.
* Total income. "Broader concept." It includes money income, retained corporate profits, the "unshifted" part of the corporate profits tax in Musgrave's study, capital gains, and income in kind.
* Musgrave's estimates based on distribution of dividends on tax returns for 1952.
holders were allocated according to the percentage distribution of total dividends by income classes (Col. 2). The allocated amounts of the corporation tax were then divided by the amounts of total family income by income classes to obtain the percentages in Columns 3-6.

If it is assumed that the corporation tax falls entirely upon consumers (Col. 3), the burden (on the basis of 1954 data) would amount to 3.4 percent of income for spending units (families) with incomes over $10,000, as compared with 5.7 percent for those with incomes from $7,500 to $10,000, and 8.0 percent for those with incomes under $2,000. On the other hand, if the corporation tax is assumed to fall entirely on stockholders (Col. 4), the burden on high income groups would be much heavier — 18.6 percent of income for families with incomes over $10,000 in 1954.

If half or one-third of the corporation tax is assumed to fall on consumers (Cols. 5 & 6), the burden of this tax appears to be approximately proportional over the low and middle ranges of income (up to $10,000) and to be progressive for higher levels of income.

Thus differences in the assumptions used about the shifting of this tax radically alter the degree of progression in the distribution of this tax, insofar as it can be estimated from available data. The assumption that the tax is borne by stockholders makes the burden appear to be progressively distributed. The assumption that the tax is shifted to consumers makes the burden appear to be regressively distributed. Other assumptions can make the burden appear to be distributed in proportion to income at least up to the $10,000 income level.

Many attempts have been made to analyze the conditions under which the corporation tax may be shifted, and to determine by statistical analysis to what extent this tax is shifted. While no consensus has been reached, the weight of expert opinion supports neither the position that the tax is fully shifted nor the position that the tax falls entirely on stockholders.

But wherever the burden of this tax may fall, it can be concluded that a progressive corporation tax would not improve the equity of the tax system. A progressive corporation tax falling on stockholders would introduce new inequities by hitting heavily families at middle and lower income levels who own stock in large corporations. A progressive corporation tax shifted forward to consumers would fall more heavily on middle and lower income families than present Federal excise taxes.

3. Progression and the Corporation Tax as an "Excise" or "Special Benefits" Tax

There are many students of public finance who believe that the corporation income tax should be regarded not primarily as an indirect tax on individuals but as a tax on corporate enterprise as such.

In the United States, corporations were taxed as such long before the individual income tax was introduced. The Federal "excise" tax on corporate net income introduced in 1909 was defended as "an excise upon the particular privilege of doing business in a corporate capacity." It is often argued that government performs many services for business and therefore on the "benefit principle" special taxes on business are justified. However, there is no evidence that the "benefits" of government services are related to a corporation's net income, since profitless corporations also receive these "benefits." The benefit principle would tend to justify a business tax related to total costs, not a progressive tax on net income.

Other writers have argued that the corporation is a separate entity with special characteristics and activities that justify separate taxation:

"... we may say that the corporation is a case where the whole is something different from the sum of its parts—directors, managers, workers, and stockholders as individuals. This is particularly true of the public corporation; less true of the privately-held corporation."

Again, however, such attempts to justify a corporation or business tax suggest a tax on gross receipts or value-added, rather than a tax on net income, much less a progressive tax on net income.

The immediate justifications for the corporation income tax are the pragmatic ones that it produces a large revenue, serves to diversify the tax system, and is relatively easy to administer. "Business is taxed because governments need revenue, experience shows business can pay taxes, and it appears expedient to tax business." For the last six fiscal years the corporation tax has produced an average of more than $20 billion, or nearly one-third of total budget receipts. The Bureau of Internal

7 Buehler, op. cit., p. 540.
Revenue made a comparison of costs of collection for the fiscal year of 1947, and found that while the corporation tax accounted for 25 percent of total tax collections it required only 10 percent of the man-hours employed in collection.  

The use of net income as the tax base also has some pragmatic justification in that it exempts from the heavy burden of the present tax nearly 300,000 corporations with no net income.  

The importance of expediency in the levying of the corporation income tax makes this tax vulnerable to pressures to use it for non-revenue purposes. Non-revenue purposes are of primary importance in recent proposals for revision of the corporation income tax. Most of these proposals are designed as a means of aiding small business, or at least of easing the special tax burdens of small business. Some are designed as a means of checking the growth of big business. These two purposes are discussed in the following sections.

C. EASING THE BURDEN ON SMALL AND NEW BUSINESSES

What are the special tax problems of small and new businesses? How significant are these problems? What tax changes are called for to ease these problems?

1. The Tax Problems of Small and New Business

The corporation tax adversely affects new and growing businesses in two major ways. First, it reduces the actual and expected rate of return on new investments. Second, it reduces the size of profits after taxes and so cuts down on the funds available for expansion.

In both these respects the effects of the corporation tax are relatively more significant for small than for large businesses. For large established enterprises losses incurred on risky investments can be written off against income from established parts of the business. For small new firms, the risk of loss may be significantly reduced by the possibility of carrying losses against the net income of future years, for losses may mean bankruptcy. For firms subject to the present rate of 52 percent, the government takes about half of a firm's net profit, but absorbs none of the losses which cannot be carried forward or backward to the net income of other years.

The relatively greater extent to which small corporations rely on retained earnings is shown in Table 6. In 1954, corporations with net incomes under $25,000 retained 81 percent of their net income after tax, while corporations with net incomes of $10 million or more retained about 37.6 percent of their net income after tax.

To the extent that the corporation tax is shifted, the impact of the tax on net rates of return and on retained earnings is reduced. But, as has been noted above, recent analyses do not support the position that the corporation tax is fully shifted. Indeed, statistical evidence suggests that the corporation tax has had a substantial impact on corporate profits. One recent study concludes:

"What is strikingly clear from the data is that the corporate system has been operating in the postwar period on much thinner real profit margins than prevailed before the depression. This is true whether real profits are related to sales, to income produced, or to any other measure of the volume of business done. Production per dollar of profits has been extraordinarily high. So has production per dollar of investment. Not only have corporations collectively made a highly efficient use of capital; they have done so for what appears to be by the test of prior experience a modest return."

The tax problems of small business, however, are not confined to the corporation income tax. There are far more unincorporated than there are incorporated small businesses. A recent report of the Internal Revenue Service shows that in 1953, there were 958,591 partnerships, with receipts of $75 billion for those showing a profit, and a total net income of $9 billion. There are discussions of small business, or at least of easing the special tax burdens of small business. Some are designed as a means of checking the growth of big business. These two purposes are discussed in the following sections.

Table 6

<table>
<thead>
<tr>
<th>Net Income Class</th>
<th>Dividends As a Percent of Net Income After Tax</th>
<th>Retained Income As a Percent of Net Income After Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Thousands)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Classes</td>
<td>51.0</td>
<td>49.0</td>
</tr>
<tr>
<td>Under $ 25</td>
<td>19.0</td>
<td>81.0</td>
</tr>
<tr>
<td>$ 25-50</td>
<td>22.9</td>
<td>77.1</td>
</tr>
<tr>
<td>50-100</td>
<td>28.6</td>
<td>71.4</td>
</tr>
<tr>
<td>100-250</td>
<td>31.6</td>
<td>68.4</td>
</tr>
<tr>
<td>250-500</td>
<td>35.2</td>
<td>64.8</td>
</tr>
<tr>
<td>500-1,000</td>
<td>40.0</td>
<td>60.0</td>
</tr>
<tr>
<td>1,000-5,000</td>
<td>52.1</td>
<td>47.9</td>
</tr>
<tr>
<td>5,000-10,000</td>
<td>60.2</td>
<td>39.8</td>
</tr>
<tr>
<td>10,000 and over</td>
<td>62.4</td>
<td>37.6</td>
</tr>
</tbody>
</table>

- Dividends in cash and assets other than own stocks.
- Net income less taxes and dividends.
- Source: See Table A2 in Appendix.

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11 J. K. Butters and J. Lintner, *Effect of Federal Taxes on Growing Enterprises*, Graduate School of Business Administration, Harvard University, Boston 1945, Part II.
are about 3 million sole proprietorships. "Nearly two out of every three of the 2.5 million new firms formed during the period 1945-50 were individually owned, one-fourth partnerships, and one-fifteenth were corporations."12

For proprietorships and partnerships the effects of individual income tax rates clearly can have serious effects on incentives when marginal tax rates of 50 percent or more apply to taxable incomes in excess of $16,000 ($32,000 for married persons). J. K. Butters and John Lintner have pointed out that:

"If a business is organized as a proprietorship or partnership, the personal income tax greatly reduces the incentive of its owners to undertake major expansions—perhaps more so than the corporate tax impedes expansions by small corporations. The highly progressive rates of the personal income tax strike with full force at the profits resulting from a partnership expansion. But if the expansion is unsuccessful and results in business failure, the partners' personal assets as well as their business assets and perhaps also their jobs will be in jeopardy."13

The individual income tax, like the corporation income tax, not only affects management incentives, but also cuts down on the funds available for expansion. The significance of personal saving as a source of investment funds for new businesses was brought out in a Department of Commerce study of sources of investment funds for the years 1945-1948. This study showed that:

"Equity financing (comprising capital stock issues and the personal saving of entrepreneurs) constituted about two-thirds of the total sources of new funds in manufacturing and trade . . .

"More than 90 percent of equity capital was financed out of the past saving of the entrepreneurs themselves, including capital stock subscriptions by the officers and directors of new corporations. The proportion of total investment financed out of personal saving decreased with increasing firm size."14

Table 7, based on this study, also indicates that "initial" investment by new noncorporate firms was larger than initial investment by new corporate firms in these years.

Indirectly, high individual income tax rates, by cutting down the capacity and willingness of individuals to invest, may also have affected the financing of new corporate businesses. The increasing flow of personal saving through financial institutions may reflect some degree tax advantages to such forms of savings. Recent studies have shown the relative decline in the importance of stock holdings and purchases of new stock by individuals. In the period 1946-1954, net issues of common stock amounted to about $18 billion; over the same period about $15 billion was acquired by financial institutions.15 Fiduciary investors are very unlikely to favor stock issues by small enterprises.

The problems of small business, however, are by no means due entirely to high taxes. There has been a substantial increase in business failures in recent years (12,686 in 1956 as compared with 8,058 in 1951), but over 90 percent of failures are due to management problems, particularly incompetence and inexperience, according to Dun and Bradstreet's analysis of the causes of failure. Moreover, the number of failures in recent years is far less than in the 1920's. In the period 1921-1925, business failures averaged 20,775 per year, and in the period 1926-1930 business failures averaged 23,605 per year.
year." It is not evident that special tax relief is an appropriate means for dealing with the peculiar difficulties of small business.

2. What Kind of Tax Relief for Small Business?

This question requires clarification of the purpose of tax relief, as well as consideration of alternative forms of tax relief.

Purpose of Tax Relief for Small Business

There is a strong presumption against attempts to make the tax system serve nonrevenue purposes. In general, such attempts are suspect because they put additional burdens on the revenue system and usually add to the complexities and inequities in the tax law. In 1955, in a statement before the subcommittee on legal and monetary affairs of the House Government Operations Committee, Secretary Humphrey said (in reference to accelerated amortization):

"If, in the wisdom of the Congress, such subsidies or assistance to special communities or for special purposes are desired, then appropriations should be made for the purpose which can be submitted to the Congress through regular channels where the amounts will be well known and where the Congress specifically can vote in favor of or in opposition to special treatment for any group."

The subcommittee on tax policy of the Joint Committee on the Economic Report in a report on Federal Tax Policy for Economic Growth and Stability (January 5, 1956) recommended that "Federal tax policy should protect and promote an atmosphere favorable for small and new businesses." The subcommittee went on to say:

"... The need of such businesses, and the reflection of these needs in public policy, do not call for a preferentially lighter real impact of the revenue system on such taxpayers as compared with larger, established companies. Differential tax treatment, however, may be required in order to offset a disproportionately heavy impact on small, new firms resulting from application of tax laws geared to the taxing ability of large, established business units."

If government assistance is to be provided to small business, it should not be through the creation of a haven under the tax law. Tax relief should be confined as far as possible to the mitigation of the special tax burdens of small business, and not used as a means of relieving the financial, managerial and other difficulties of small and new businesses.

Alternative Forms of Tax Relief

In view of the fact that the vast majority of small and new firms are not incorporated, it would make little sense to use a reduction in the corporation tax rate as a means of reducing the tax burden on small business in general. In considering the Tax Rate Extension Act of 1957, the Senate Finance Committee rejected amendments which would have reduced the corporate tax rate on small corporations on the ground that:

"... the corporate rates offered in the committee do not provide the desired result. Most small businesses are unincorporated, being partnerships or sole proprietorships. Only 10 to 15 percent of the total number of operating businesses are corporations. Your committee sees no justification for tax reduction which would benefit only this small corporate segment and thus discriminate against the many small business firms which are not incorporated."

Various proposals for structural and technical tax changes favorable to small business have been made.

The major questions with respect to the corporate tax are whether revision is needed in the present $25,000 surtax exemption and in the relation of the normal tax rate (now 30 percent) and the surtax rate (now 22 percent).

The purpose of the surtax exemption is to mitigate the burden on small business of a high tax on corporations in general. The present structure of the corporation tax was adopted in 1950 as a substitute for the unsatisfactory "notch" provision under previous law by which small corporations with a net income between $25,000 and $50,000 were subject to a marginal tax rate 15 percentage points higher than the general corporation tax rate. In its report on the Revenue Act of 1950 the Senate Finance Committee said:

"The substitution of a surtax exemption of $25,000, available to all corporations, for the present 53 percent notch rate preserves the tax advantages enjoyed by small business without introducing a system which is readily adaptable to a drastic graduation in rates ... A single exemption of the type in the bill best expresses the idea of a flat tax rate modified by a concession for small business."

It has been proposed that the surtax exemption be increased as a means of aiding small business. For example, H.R. 35 introduced in 1957 would have raised the exemption to $50,000 over a five-year period. While an increase in the exemption would tend to favor small business, it would be a poor alternative to a reduction in the present marginal rate of 52 percent on taxable income over $25,000. In 1954, the present $25,000 exemption excluded 361,000 corporations with net income from application of the surtax. A $50,000 exemption would have removed only 35,397 more corporations from the application of the surtax. An increase in the exemption would have little effect in reducing the adverse effects on business decisions of a marginal tax rate of 52 percent: a small, growing corporation would still be confronted with the government taking more than half its
It may be argued that the rise in the general level of prices since 1950 provides grounds for an increase in the surtax exemption. For the first half of calendar 1957, the consumers' price index was 19 percent higher than in the first half of 1950. Such an increase, however, would only justify an increase in the exemption to about $30,000.

In 1957 numerous bills were introduced that would have lowered the normal tax rate and raised the surtax rate. That the normal tax rate is relatively high is self-evident since there has been no reduction in this rate since the Korea War. As reported by the House Committee on Ways and Means before the outbreak of the Korea War, the Revenue Act of 1950 would have taxed all net income at a normal tax rate of 21 percent and net income in excess of $25,000 at a surtax rate of 20 percent. Under the Excess Profits Tax Act of 1950 and the Revenue Act of 1951, the normal tax rate was raised to 30 percent and the surtax rate to 22 percent, the level where these rates still remain.

The major post-Korean reduction in corporate tax liabilities was the repeal of the excess profits tax which did not apply to taxable income under $25,000. In 1954 individual income tax liabilities were reduced by about 10 percent. Thus corporations with net incomes of $25,000 or less are still subject to a wartime rate.

A reduction of the normal tax rate, however, would apply to all corporations—it would be a general tax reduction and so would have to be considered in the light of priorities for general tax reductions.

The proposal to offset the revenue loss from a reduction in the normal tax by an increase in the surtax rate would mean, as President Eisenhower pointed out, increasing the tax burden on some taxpayers in order to provide relief for others. This observation applies even more forcibly to proposals for a progressive corporation tax. Moreover, to avoid a revenue loss, an interchange of the normal and surtax rates would require an increase in the combined normal and surtax rate on all income in excess of $25,000 to 53 percent. Such a change would increase rather than mitigate the adverse effects of the present tax.

Other tax changes have been proposed that would involve little revenue loss and be advantageous both to corporate and unincorporated small business. In August 1956, the President's Cabinet Committee on Small Business recommended various tax changes most of which were again recommended by the President in a letter to the chairman of the House Committee on Ways and Means, July 15, 1957. In that letter the President opposed any rate reduction at least until July 1, 1958. He proposed the following changes which, he said, "Pending the achievement of budgetary conditions that will permit a general program of tax reduction, ... would appreciably improve the ability of small business to get started, and, once started, to grow".  

(1) Permit the depreciation formulas allowed on new property under the Internal Revenue Code of 1954 to be utilized on purchases of used property not exceeding $75,000 in any one year;
(2) Give corporations with a small number of stockholders the option of being taxed as partnerships;
(3) Give taxpayers the option of paying the estate tax over a period of up to ten years in cases where the estate consists largely of investments in closely-held business concerns;
(4) Permit an original investor in a small business the right to deduct from his income, up to some maximum prescribed by Congress, a loss, if any, realized on a stock investment in such business.

C. CHECKING THE TREND TOWARD BIGNESS

It has been shown above that a progressive corporation tax cannot be justified on grounds of equity. Neither can it be justified as a means of aiding small business. Is there a need for a progressive corporation tax as a means of checking the growth of the monopoly power?

It has been argued that a progressive corporation tax should be adopted in order "to check the wave of corporate mergers and consolidations and...to encourage a competitive structure of business." It is true that there has been a "wave of mergers" in recent years, a wave which has provoked extensive discussion and analysis. But the extent and significance of this wave have probably been exaggerated (Chart 2).

"Since 1949 the pace of important mergers and acquisitions has been rising; in 1954 the number reported in financial manuals was three times that of 1949, and just slightly less than the number reported for each of the years 1946 and 1947 when merger activity reached a post-war peak. Nevertheless, mergers and acquisitions were occurring at a substantially lower rate in 1954 than during the later twenties."  

The recent "wave of mergers" has also provoked more vigorous antitrust action. In 1950 Congress passed an Anti-merger Act which amended the Clayton Act by outlawing mergers or consolidations tending to lessen competition whether accomplished by outright purchase of assets (previously not covered by the Clayton Act)

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19 Representative Patman, Congressional Record, February 7, 1956, Vol. 102, No. 21, p. 1952.

The number of mergers and acquisitions in manufacturing and mining, as seen in Chart 2, shows a trend of fluctuation over the calendar years 1919-1959. The chart illustrates that the number of acquisitions peaked around 1929 and 1949 but generally remained stable with minor fluctuations. The source of the data is the Federal Trade Commission.

The significance of the recent merger movement in limiting competition cannot be easily assessed. However, it seems evident that the role of taxes in inducing mergers has been relatively minor. Even though imperfections and gaps in the data counsel caution, the best available evidence establishes a rather strong presumption that there has been no increase in over-all concentration over the last 50-year period and indicates that there probably has been some decrease in concentration over this period, at least so far as manufacturing is concerned. Such broad stability (i.e., zero or negative trend) cannot be readily explained by secularly rising taxes. Neither can the known fluctuations in the degree of concentration within this half-century be readily or consistently explained by concomitant changes in tax rates within the period.

"Subject to a fairly wide margin of error, our estimate is that taxes were of major importance for something less than one-tenth of the total number of mergers of manufacturing and mining companies reported in the financial manuals for the years 1940 through 1947."23

In view of the relatively minor role of taxes in inducing mergers and acquisitions, it may be doubted that changes in the corporate tax structure could be used as an instrument to "check the wave of corporate mergers" without incorporating special penalties.

Representative Patman's proposal, far from "encouraging" a competitive structure of business, would provide a heavy penalty on large business, a strong inducement to corporate split-ups, and because of its progressive structure of rates, would be an impediment to corporate growth.

Under this proposal (H.R. 7) the surtax exemption would be raised to $100,000. The rate on the first $100,000 of taxable income would be 22 percent; the

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21 Ibid., p. 148.
Table 8
CORPORATION INCOME TAX RATES AND BRACKETS
UNDER H.R. 7
(INTRODUCED BY REPRESENTATIVE PATMAN,
89TH CONGRESS, 1ST SESSION)
AND NUMBER OF CORPORATIONS BY CORRESPONDING
SIZE OF NET INCOME
1954 and 1956

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Proposed Rates H.R. 7</th>
<th>Corporations with Net Income 1954</th>
<th>Industrial Firms and Utilities 1954</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Thousands)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>First $100</td>
<td></td>
<td>22%</td>
<td>415,239</td>
</tr>
<tr>
<td>$ 100 to 500</td>
<td></td>
<td>32</td>
<td>19,204</td>
</tr>
<tr>
<td>500 to 1,000</td>
<td></td>
<td>39</td>
<td>2,953</td>
</tr>
<tr>
<td>1,000 to 5,000</td>
<td></td>
<td>44</td>
<td>2,689</td>
</tr>
<tr>
<td>5,000 to 10,000</td>
<td></td>
<td>51</td>
<td>432</td>
</tr>
<tr>
<td>10,000 to 37,000</td>
<td></td>
<td>54</td>
<td>226</td>
</tr>
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<td>37,000 to 50,000</td>
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</tr>
<tr>
<td>50,000 to 100,000</td>
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<td>460</td>
</tr>
<tr>
<td>100,000 to 500,000</td>
<td></td>
<td>64</td>
<td>34</td>
</tr>
<tr>
<td>500,000 to 1,000,000</td>
<td></td>
<td>71</td>
<td>15</td>
</tr>
<tr>
<td>1,000,000 to 5,000,000</td>
<td></td>
<td>75</td>
<td>3</td>
</tr>
</tbody>
</table>

  industrial firms and utilities (communication and transportation) as reported in the Fortune Directory of 500 Largest Industrial Corporations.
  Net available.
  $37 million is the income at which the tax under Patman's proposed rates would begin to exceed the tax under 1957 rates.
  Source: Treasury Department and Fortune Magazine.

combined normal and surtax rates on the next $400,000 of taxable income would be 32 percent, and on the next $500,000, 39 percent; the rate would rise to 75 percent on taxable income in excess of $1 billion.

Table 8 shows the proposed rate schedule and the number of corporations that might be subject to the various rates. It is evident that this rate schedule would put a severe penalty on size and growth. The tax under the proposed schedule would be less than under the existing rates for all corporations with taxable incomes under $37 million. Part of the corporate tax burden would be shifted to the relatively few corporations with taxable incomes of more than $37 million. According to the Fortune Directory of the 500 Largest Industrial Corporations there was in 1956 no firm with a net income of more than $1 billion, and there were only 83 manufacturing firms and utilities that would have been subject to a larger tax under H.R. 7 than under present rates. Marginal rates of 61 to 75 percent would be nearly equivalent, for the largest firms, of a return to the wartime excess profits tax.

The high surtax exemption and the sharp jumps in the rates at higher income levels would induce efforts to avoid the higher tax rates and would provide a check on the growth of corporations, whatever the reasons for that growth. The "check" would be related only to the size of net income. But there is no presumption that size of net income is a good indication of monopoly power. Patman's proposal would check growth even at the cost of achieving more efficient forms of organization and production. His proposal is to put a penalty on bigness as such.

The fact is that there are other and much more appropriate means for checking the growth of monopoly power. As indicated above, the anti-trust laws in recent years have been tightened and vigorously enforced. In the Federal Trade Commission and the Justice Department we have administrative agencies where the problems of distinguishing and dealing with monopoly positions can be dealt with directly. Tax measures are not appropriate to such purposes.
III. REVISION OF THE RATE STRUCTURE VS. A GENERAL REDUCTION IN THE CORPORATION INCOME TAX

The question of what changes are needed in the corporation income tax necessarily involves both revision and reduction in the corporation tax rates. Revision of the rate structure is likely to involve some general tax

A. PROPOSALS FOR PROGRESSION IN THE CORPORATION TAX

The preceding analysis has shown that a progressive corporation income tax cannot be justified on any general principle of taxation or on grounds of the special tax problems of small business. The principle of ability to pay cannot be applied to corporations as it is to individuals. If the corporation tax is regarded as merely an indirect way of taxing individuals, progression in the corporation tax would aggravate rather than reduce inequities among individuals. On the other hand, if the corporation tax is viewed as a tax on corporate enterprise as such, and justified on the "benefit principle" of taxation, no basis for progression can be found; the "benefits" of government services are not related to a corporation's net income.

The special tax problems of small business can scarcely justify tax relief for small corporations. Only 10 to 15 percent of the total number of all businesses is incorporated. To small business as a whole, the individual income tax is of more importance than the corporation income tax. Relief for the special tax problems of small business should be related to the individual income tax as much as to the corporation tax.

B. OTHER PROPOSALS FOR MODIFICATION OF THE CORPORATE RATE STRUCTURE

It has been proposed that the surtax exemption be increased as a means of aiding small business. But an increase in exemptions would affect only a small proportion of small corporations, and since it would amount to a general tax reduction, it would merely serve to postpone reduction of the general rate of the tax.

Current proposals to reduce the normal tax rate and offset the revenue loss by increasing the surtax rate would mean an increase in the general rate of the corporation tax and would tend to increase its distorting effects (see below). Moreover, it would mean arbitrarily increasing the tax burden on some taxpayers in order to provide relief for others.

It is clear that the normal tax rate on the first $25,000 of net income is relatively high. Effective rates on corporate net incomes of $25,000 or less were raised by about one-third during the Korean War, and no reduction in the tax on such incomes has been made since.

But since a reduction in the normal tax rate would apply to all corporations, it would have to be considered in the light of priorities for general tax reduction.

C. A GENERAL REDUCTION IN THE CORPORATION INCOME TAX

The present corporation tax rate of 52 percent leaves less than half of corporate profits to be disposed of as management and stockholders see fit. At this level the corporate tax is a serious impediment to expansion of all sizes of business. It cuts deeply into the sources of equity funds and reduces the expected rates of return that provide incentive for new investment.

The effect of high tax rates on corporate investment have been offset in part by inflation in producing an overstatement of profits. A recent calculation by the Machinery and Allied Products Institute indicates that, for the period 1947-1956, corporate profits as reported by the U. S. Department of Commerce exceeded by $43 billion, or 31 percent, a corrected figure for profits ad-
justed for the following:

"(1) the difference between the historical cost of fixed-asset consumption (depreciation) and its current-dollar equivalent;

"(2) the difference between the historical cost of inventory consumption and its current-dollar equivalent, and

"(3) the excess of special amortization over normal depreciation (for years since 1950)."

(The latter adjustment increased the reported profits figures). Corporate net saving, that is, retained earnings, after the same correction, is calculated to have been only 55 percent of the reported saving. "The ratio of corrected saving to income produced has been lower by more than 25 percent than in the pre-depression period."

For the same reasons the effective rate of the corporation tax on corrected profits has been considerably above the stated rate. For the period 1952-1956, dur., which the stated rate of the tax was 52 percent, the effective rate on corrected profits averaged 57.1 percent.

Inflationary conditions have undoubtedly been conducive to the shifting of the corporation tax. As has been noted above, to the extent that the corporation tax is shifted, the impact of the tax on net rates of return and on returned earnings is reduced.

Forward shifting of this tax to the consumer does not add to its good points. Forward shifting tends to put more of the burden of the tax on middle and lower income groups, and discriminates between corporate and noncorporate business. It is hardly conceivable that anyone would seriously propose an excise or sales tax on the products of corporations to the exclusion of the same products produced by unincorporated businesses.

The inflation of the past decade and the tremendous post-World War II needs for capital expenditures have obscured the effects of high corporation tax rates on business investment. Korean War demands and accelerated amortization have also made it difficult to isolate the effects of corporation tax rates. In addition, the Internal Revenue Code of 1954 liberalized depreciation provisions and deduction provisions relating to research and development expenditures. Thus, the effects of the corporation tax on investment have been at least temporarily mitigated.

The present high rate of the corporation tax not only reduces the incentive and capacity to invest, it also affects managerial decisions; for example, the 52 percent rate provides an incentive to debt rather than equity financing, for interest payments are a deductible expense while dividends are not. The high rate also tends to encourage current spending when these expenditures are made in "48-cent dollars." "There can be no doubt that, when the corporate income-tax rate is as high as it now is, it will have a significant effect on deductible expenditures for expansion, business promotion, and goodwill development, and on such items as employees' life insurance, sick benefits, pension and profit-sharing plans, executives' expense accounts, and charitable contributions . . ." To the extent that the corporation tax stimulates certain types of spending, the effectiveness of this tax in reducing inflationary pressures is diminished.

For the long run, a corporation tax which takes more than half of corporate profits, makes government too important a "silent partner" in corporate enterprise.

D. CONCLUSION

A long range view is required if we are to move toward a more desirable and equitable tax system. More consideration than can be undertaken here should be given to the role of the corporation income tax and of excise taxes in the Federal tax system, and to the major revisions needed in that system. While the Internal Revenue Code of 1954 provided for liberalized depreciation provisions, a dividend credit, and modified provisions for deductions, this code was largely a technical revision of the tax law. There has been no general overhaul of the major features of the tax structure since before World War II.

The effects of the present corporation tax on the capacity and willingness to invest and the distorting effects on different types of expenditures argue for a general reduction in this tax. The fact that the corporation income tax rate is at an all-time high, and remains at its wartime peak five years after the end of the Korean War, provides a strong presumption in favor of reduction in this tax.

The principal conclusion to be reached is that the most important change needed in the corporation income tax is a reduction in rates. A general reduction in the normal corporate tax rate would be of more importance to the economy than any modification of the tax for special purposes. It would be relatively favorable to small corporations; it would reduce the marginal rate on additional
income for growing concerns; it would add to the sources
of funds for investment; it would lower the total rate
on all corporations and so mitigate the distorting effects
of the present rate on business decisions.

The timing of a reduction in the corporation tax rate
will depend upon the achievement of substantial surplus
in the Federal budget for tax reduction. Corporate tax
reduction must be weighed against increases in Federal
expenditures, reduction in the Federal debt, and re-
ductions in individual income and excise taxes.

The conclusion of this study is that when substantial
tax revision and reduction become possible, the change
most needed in the corporation income tax is a reduction
in the normal tax rate.
### APPENDIX TABLES

#### Table A1
**TOTAL FEDERAL TAX COLLECTIONS AND COLLECTED FROM CORPORATION INCOME AND PROFITS TAXES**
*Fiscal Years 1925-1957*

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Federal Tax Collections*</th>
<th>Corporation Income and Profits Tax Collections</th>
<th>Corporation Income and Profits Tax Collections</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Millions</td>
<td>Amount</td>
<td>Percent of Total Tax Collections</td>
</tr>
<tr>
<td>1925</td>
<td>$ 3,132</td>
<td>$ 916</td>
<td>29.2</td>
</tr>
<tr>
<td>1926</td>
<td>3,415</td>
<td>1,095</td>
<td>32.1</td>
</tr>
<tr>
<td>1927</td>
<td>3,471</td>
<td>1,308</td>
<td>37.7</td>
</tr>
<tr>
<td>1928</td>
<td>3,360</td>
<td>1,292</td>
<td>38.5</td>
</tr>
<tr>
<td>1929</td>
<td>3,641</td>
<td>1,236</td>
<td>34.9</td>
</tr>
<tr>
<td>1930</td>
<td>3,627</td>
<td>1,263</td>
<td>34.8</td>
</tr>
<tr>
<td>1931</td>
<td>2,807</td>
<td>1,025</td>
<td>36.6</td>
</tr>
<tr>
<td>1932</td>
<td>1,885</td>
<td>630</td>
<td>33.4</td>
</tr>
<tr>
<td>1933</td>
<td>1,871</td>
<td>394</td>
<td>21.1</td>
</tr>
<tr>
<td>1934</td>
<td>2,296</td>
<td>400</td>
<td>13.4</td>
</tr>
<tr>
<td>1935</td>
<td>3,610</td>
<td>579</td>
<td>16.0</td>
</tr>
<tr>
<td>1936</td>
<td>3,881</td>
<td>953</td>
<td>24.6</td>
</tr>
<tr>
<td>1937</td>
<td>5,121</td>
<td>1,088</td>
<td>21.2</td>
</tr>
<tr>
<td>1938</td>
<td>6,003</td>
<td>1,343</td>
<td>22.2</td>
</tr>
<tr>
<td>1939</td>
<td>5,481</td>
<td>1,156</td>
<td>21.1</td>
</tr>
<tr>
<td>1940</td>
<td>5,721</td>
<td>1,148</td>
<td>20.1</td>
</tr>
<tr>
<td>1941</td>
<td>7,912</td>
<td>2,053</td>
<td>26.3</td>
</tr>
</tbody>
</table>

* Internal revenue collections plus customs and, beginning with 1940, railroad unemployment insurance act taxes (before refunds).

Source: Treasury Department.

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#### Table A2
**NUMBER OF RETURNS, NET INCOME, TAXES, AND DIVIDENDS PAID CORPORATIONS WITH NET INCOME**
*By Net Income Classes*  
*Income Year 1954*

<table>
<thead>
<tr>
<th>Net Income Class</th>
<th>Number of Returns</th>
<th>Net Income</th>
<th>Taxes*</th>
<th>Net Income After Taxes</th>
<th>Dividends*</th>
<th>Retained Income*</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Thousands)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under $ 25</td>
<td>360,965</td>
<td>$ 2,208</td>
<td>$ 596</td>
<td>$ 1,612</td>
<td>$ 306</td>
<td>$ 1,306</td>
</tr>
<tr>
<td>$ 25- 50</td>
<td>35,397</td>
<td>1,219</td>
<td>396</td>
<td>823</td>
<td>188</td>
<td>634</td>
</tr>
<tr>
<td>50- 100</td>
<td>18,877</td>
<td>1,320</td>
<td>521</td>
<td>800</td>
<td>229</td>
<td>571</td>
</tr>
<tr>
<td>100- 250</td>
<td>13,805</td>
<td>2,141</td>
<td>926</td>
<td>1,215</td>
<td>384</td>
<td>831</td>
</tr>
<tr>
<td>250- 500</td>
<td>5,399</td>
<td>1,886</td>
<td>845</td>
<td>1,041</td>
<td>366</td>
<td>675</td>
</tr>
<tr>
<td>500- 1,000</td>
<td>2,953</td>
<td>2,058</td>
<td>940</td>
<td>1,118</td>
<td>447</td>
<td>670</td>
</tr>
<tr>
<td>1,000- 5,000</td>
<td>2,889</td>
<td>6,000</td>
<td>2,705</td>
<td>3,295</td>
<td>1,716</td>
<td>1,579</td>
</tr>
<tr>
<td>5,000-10,000</td>
<td>432</td>
<td>3,052</td>
<td>1,371</td>
<td>1,681</td>
<td>1,013</td>
<td>669</td>
</tr>
<tr>
<td>10,000 and over</td>
<td>460</td>
<td>19,698</td>
<td>8,561</td>
<td>11,128</td>
<td>6,942</td>
<td>4,156</td>
</tr>
<tr>
<td>Total</td>
<td>441,177</td>
<td>39,573</td>
<td>16,861</td>
<td>22,712</td>
<td>11,591</td>
<td>11,121</td>
</tr>
</tbody>
</table>

* Includes a small amount of excess profits taxes. The excess profits tax was repealed as of December 31, 1953.

* Dividends in cash and assets other than own stock.

* Net income less taxes and dividends.

Source: Treasury Department.