

BOOK REVIEW

REAPPRAISAL OF BUSINESS TAXATION. SYMPOSIUM CONDUCTED BY THE TAX INSTITUTE. Princeton: Tax Institute, Inc., 1962. Pp. xii, 242. \$6.00.

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The theory and problems of business taxation have provided subjects for discussion in a number of the annual symposiums of the Tax Institute. These subjects were reappraised at the 1961 symposium. The papers of 17 speakers and the discussion which accompanied them are presented in this volume. The participants were economists, attorneys, accountants, state tax officials, corporation tax managers, and other students of taxation.

In the aggregate, federal, state, and local governments raise many billions of dollars from taxes imposed and collected from business. That this system of business taxation is not a coherent one becomes clear when one examines the patchwork of taxes put together over the years. Such basic questions as what is business, why, how, and how much should it be taxed, have been brushed aside in the persistent search for more revenue.

In practice, of course, business must both be taxed itself and be used as a vehicle for the collection of taxes aimed at individual income recipients. However, what is often dismissed as a tax on business may in reality be a tax on consumers, employees, investors, or other individuals. These taxes are bound to influence economic activity in the national, state, and local communities.

Except to the diffusionist who thinks that all taxes are automatically diffused through the community, the particular pattern of taxation utilized to raise large revenues is a matter of great importance. Even some diffusionists feel that the economy is disturbed less by imposing taxes directly on the individuals who must finally pay them. Continuing complaints by business about the effects of corporate income, franchise, and other taxes in retarding investment and economic growth indicate that business does not escape the consequences of these taxes. Taxes which are assumed to be shifted frequently are not. The particular pattern of taxation, then, does make a difference.

The papers in Part One of the symposium are concerned with the role of business as an object of taxation. Professor Harold M. Groves admirably appraises theories of business taxation and their application. (Pp. 3-16.) He demonstrates the difficulties encountered by the economist in any effort to distinguish business from other economic activity. Taxes may be levied on a privilege relating to business or on the income of the

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business. This tax may then be shifted by the business to the consumer or to another class. If an attempt is made to limit the tax to production, it is found that production and consumption cannot clearly be separated and that taxes on producers may become taxes on consumers.

It may seem sensible to tax business solely on the basis of benefits received from government. Benefits, however, may not be measurable, and such a tax may bear no relationship to the capacity of the firm to pay. Not only may business taxation conform neither with benefits nor with ability to pay, but corporate taxes may be quite disproportionate when considerations of fiscal and political expediency outweigh other factors.

Professor Groves raises so many critical questions that the reader may feel business taxation should be abandoned or at least minimized. How should corporate and personal income taxes be coordinated? How may distributed and undistributed profits be taxed with neutrality? Professor Groves assumes that business is going to be taxed, and therefore the question is how and how much.

Solomon Barkin, a labor union official, states bluntly that proposals to eliminate the corporate income tax are academic and that the proportion of federal revenue obtained from this source cannot be changed. (Pp. 17-24.) He believes that corporate activity has so adapted itself to the tax that it now encourages stability and economic growth. He refers to the net operating loss carryover as a stabilizing factor. However, he does not support his assertion of the growth effect with any more than an observation that the tax certainly has not deterred growth. He thinks that a very substantial part of the corporate income tax is absorbed by "the original business enterprises" (p. 18) and that the tax is not a general sales, or consumer, tax. Mr. Barkin favors a flexible program of tax penalties and rewards to promote growth, with considerable discretion granted to the administration in varying the tax pressures applied to business activity. Regulatory taxation would be employed as a tool of fiscal policy.

Leonard E. Kust, a tax attorney, argues that too much reliance has been placed on the corporate income tax, and that our taxation is out of line with that of European countries. (Pp. 25-32.) He would reduce the tax rate from 52 percent to about 25 percent and supplement the tax with a value-added tax, a turnover tax, a manufacturers' excise tax, or some combination of the three. The value-added tax would, in large measure, overcome the criticism of tax pyramiding and the encouragement of business integration. The turnover tax has cumulative effects but it has the broadest base and has been used in many countries. A manufacturers' excise would entail less pyramiding but would have a more limited base. No tax is perfect, Mr. Kust declares, but a "medley of taxes" (p. 26) provides the best balance.

Part Two of the symposium considers certain problems relating to the form of business organization. Leonard L. Silverstein, an attorney, notes the many inequalities in taxes on the income of incorporated and unincor-

porated undertakings. (Pp. 55-64.) He cites the different treatment of distributed and undistributed income, capital gains, ordinary income, exemptions, and measures used to avoid or reduce taxes. He argues that tax differentials should be related to the nature of business activities, taxable capacities, revenue requirements, and economic policies, rather than to the form of business organization. He concedes that this is a controversial proposal.

Part Three is devoted to a discussion of selected problems of state taxation. Attention is given to the troublesome questions arising from the taxation of interstate sales and income. John F. Tarrant, Counsel and Director of Research of the Connecticut Tax Department, makes a plea for the states to settle their differences with a minimum of federal interference. (Pp. 67-75.) He believes that there is no formula which all state tax officials and taxpayers will acclaim as satisfactory. But, at the same time, he fears that federal legislation may result in undesirable limitations on state taxing powers. Tax statemanship is therefore needed on the part of state tax officials and taxpayers to achieve the desired harmony.

In dealing with conflicts in the allocation of business income among the states, Ira J. Palestin, New York State Tax Commissioner, emphasizes the varying treatment accorded the sales factor. (Pp. 86-94.) Uniformity in allocation preferably should be sought through voluntary state cooperation rather than by the coercion of federal law. The New York approach to allocation is to allow a deduction from a corporation privilege tax rather than from a direct income tax, coupled with the use of the three-factor Massachusetts formula. Sales are apportioned by New York between the state where the shipment originated and the state of destination. The discussion here, as in other parts of the symposium, was restricted, and did not present the full range of arguments and proposals. As the participants state, these problems are being studied by a subcommittee of the House Judiciary Committee.

The papers in Part Four deal with investment and economic growth. William M. Horne, Jr., a corporation tax manager, discusses the taxation of capital gains arising from the disposition of depreciable personal property. (Pp. 103-12.) He proposes that taxation should be a neutral factor in business decisions. He questions the wisdom of proposals to extend ordinary income treatment to gains of personal and real property.

Professor Dan Throop Smith, formerly Assistant Secretary of the Treasury, carefully appraises depreciation, obsolescence, and depletion policies at some length. (Pp. 113-28.) He accepts the need for more liberal and realistic depreciation policies to encourage investment and growth. Modernization of machinery, tools, and equipment is needed to cut costs of production and improve the position of business in foreign competition. He stresses the importance of revised depreciation schedules related to changed conditions and the economic outlook and urges that

depreciation policies be consistent with the objectives of a dynamic and growing economy. Service lives somewhat shorter than probable useful lives are further advocated. Canadian and British precedents on this matter are praised.

Professor Smith argues that with faster depreciation it may be essential to tax gains on depreciable real and personal property as ordinary income to prevent giving undue tax advantages. To avoid discouraging capital replacement, the gain might be applied to a reduction of the tax basis of newly acquired property, a policy followed in other countries. To make the income tax consistent with economic growth objectives, faster depreciation is preferable to investment credit. Any credit going beyond a deduction for actual cost would be illogical.

In appraising the treatment of depletion, Professor Smith finds the traditional equity arguments unconvincing. He is impressed, however, with the argument that percentage depletion is desirable for foreign production. Reducing rates of depletion on such production would invite higher foreign taxes and probably not increase federal revenues. The cost of domestic oil and minerals is comparatively high, and reduced rates of depletion would increase our competitive disadvantage in foreign trade. Since these commodities are necessary for national defense, differential taxation may be warranted to assure adequacy of supply. Before depletion allowances are modified, the possible economic effects of reducing them should be appraised.

The investment credit proposed in 1961 is discussed by Alan L. Gornick, a tax attorney and corporation tax manager. (Pp. 129-41.) He argues eloquently that faster depreciation is preferable to investment credit in order to promote economic growth. He finds the proposed credit complicated and inequitable, giving windfalls to companies which would increase investment without it. Uncertainties as to future policy on investment credit would handicap investment, as shown by the British experience. Rather than the investment credit, an increased depreciation allowance in the first year should be adopted. Depreciation allowances should not, however, exceed actual costs. Both administrative and legislative action are advocated to accomplish this reform.

Professor Robert S. Holzman deals with expansion plans and the taxation of accumulated earnings. (Pp. 142-50.) Corporations encounter many obstacles when they retain earnings in order to enter a new business. If they want to engage in a new business beyond their own field, they must act with care to avoid paying a penalty tax.

Part Five is a discussion of the reconstitution of business taxes. The problem of taxation is thoughtfully explored by Professor E. Gordon Keith. (Pp. 175-86.) He finds that prevailing opinion endorses some differentiation in tax rates on small and large corporations. As a rule, small firms rely heavily on retained earnings to finance growth, cannot shift any great part of their income tax, and tend to have more variations in losses

and income, with the resulting possibility that they cannot offset losses against income to the same extent as large corporations. However, the lower tax rate on small firms has invited the creation of multiple corporations to minimize taxes, and further rate graduation might increase abuses. Professor Keith concludes, after appraising various alternatives, that the present rate structure offers the best means for differentiating the tax treatment of small and large corporations.

As to the taxation of cooperatives and mutual financial institutions, Reuben Clark, an attorney, argues for similar taxation of comparable income of ordinary business and other competitive corporations. (Pp. 200-14.) Comparative equality of taxation is difficult to attain however, and various approaches are considered for cooperatives. Mr. Clark suggests that income attributable to manufacturing, processing, mining, and assembling should be excluded from patronage refunds and taxed at the full corporate rate whether distributed or not. This would compare with the taxation of unrelated business income of charitable institutions. Comparable taxation should be sought in the taxation of mutual and commercial banks.

Norman A. Sugarman, a tax attorney, analyzes the taxation of business income of exempt organizations, focusing on revenue and regulatory problems. (Pp. 215-31.) Complications inevitably arise in defining business income. A choice must be made between a policy under which organizations are either totally or not at all exempt and a policy under which organizations with business income may qualify for partial exemption. The latter alternative may seem unsound in theory, but it is practicable, and permits a compromise of many problems which would otherwise be insoluble.

The symposium treats only selected aspects of the taxation of business, but perhaps an even smaller range of topics would have permitted more penetrating discussion and would have highlighted the opposing points of view. Taxation, by its nature, involves many substantive issues as well as administrative and practical complications. This, of course, was well known to the Program Committee, which no doubt sought to select topics that would interest as large an audience as possible. In the discussion periods which followed the presentation of papers a more adequate discussion of some questions developed. (Pp. 232-42.) On the whole, the papers should be stimulating, informative, and enjoyable to readers seeking to broaden their knowledge of business taxation.



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