NOTES

The Federal Excess Profits and Capital Stock Tax

The taxes on corporate capital stock and profits in excess of a fair return, assessed by the novel method of using a single base arbitrarily set by the taxpayer, were revived together as a temporary measure to finance New Deal legislation,[1] but apparently are here to stay.[2] Since Congress in the last session made no changes in the 1935 Statute and gave little hope for curtailment of national spending, it seems that the stop-gap measure has become a permanent impost on corporations.[3] Consequently, it is pertinent to inquire into the history and features of the tax, the methodology of computing the adjusted declared value base, the mechanics of its annual adjustment, and its validity.

The history of these taxes had its origin at the close of the World War, at which time there was need for revenue. The capital stock tax, which originated in the United States in 1916 [4] and was enforced for a period of ten years, provided for a levy of an excise tax for the privilege of doing business upon all associations having a capital stock represented by shares. The tax was based upon an evaluation of the assets invested in the enterprise,[5] the impost being measured by .05 per cent. of the valuation, with an exemption of $99,000.

The excess profits tax was first considered in Sweden and was adopted rapidly by the war impoverished countries, including England, France, Italy, United States, Germany and Spain.[6] These taxes were based upon the general theory that a certain return upon investment was justified, but that excess profits, since they were in most instances a direct result of the war, should be taxed heavily.[7]

Various methods were used in determining the normal return. In Germany, for example, the profits for five years preceding the war were first ascertained, the best and worst years eliminated, and the average of the remaining three years was taken as normal for that business.[8] Any returns above the average amount were taxed on a steeply graduated basis.

In the United States, the excess profits tax, as enacted for the first time on March 3, 1917,[9] had no relation to the capital stock tax. The Act provided for a normal return of 8 per cent. of the capital stock of corporations, as shown by their income tax returns; a $5000 deduction above that amount was allowed for close margins. The remaining profit was taxed at 8 per cent. But before any revenue was collected under this Act, it was repealed.[10] In the same year Congress passed a similar statute which applied to individuals as well as corporations,

1. The N. I. R. A. provided for automatic repeal of the taxes on the contingency of a balanced budget or the end of prohibition. 48 STAT. 208 (1933).

2. See Nelson, *Corporate Tax Problems* (1937) 15 TAX MAG. 123, 124. The same man predicted in 1934 that these taxes would be a permanent part of the tax system, N. Y. Times, June 17, 1934, § 2, p. 9, col. 3. *Cf.* Advice of the N. Y. Bd. of Trade that Act would soon be changed. N. Y. Times, July 30, 1934, p. 23, col. 3.

3. For present form of the tax, see 49 STAT. 1017, 1733 (1935-36), 26 U. S. C. A. § 1383a (Supp. 1936) (Capital Stock); 49 STAT. 1019, 1733 (1935-36), 26 U. S. C. A. 342 (Supp. 1936) (Excess Profits).

4. 39 STAT. 789 (1916), *repealed by* 44 STAT. 125 (1926).

5. See Ray Copper Co. v. United States, 268 U. S. 373 (1925) for a discussion of methods of evaluation of this amount.

6. Stamp, *The Taxation of Excess Profits Abroad* (1917) J. OF ROYAL ECON. SOC. 26, 27, 28. See N. Y. Times, Oct. 20, 1937, p. 1, col. 1, for account of Italy's new 10% capital stock levy.

7. *Id.* at 27.

8. *Id.* at 29.

9. 39 STAT. 1000 (1917).

10. See HOLMES, FEDERAL TAXATION (1923) 1213.

but because of administrative difficulties,[11] it was superseded by the Act of 1918 applicable to corporations only.[12] This latter statute provided for the expiration of the tax in 1921, and it was not revived until 1933.

I. *The Present Act*

In accordance with the scheme developed in 1933 of new taxation to increase revenues, the capital stock tax was resurrected, and the ingenious idea of forcing a fair capital stock valuation by an excess profits levy on the same tax base was evolved.[13] Former taxes of this genus were unrelated, since the statutory basis for calculating the amount of the levy under the earlier capital stock tax was actual investment value, while the excess profits levy was based upon a normal profit on net income. The Act in question related these two taxes, using as the base for the capital stock tax the arbitrary figure of "adjusted declared value",[14] and levying an excess profits tax on all income over a fixed percentage of that amount.

In accordance with the provisions of the Act of 1933,[15] its operation was automatically terminated by the repeal of the Eighteenth Amendment in December, 1933.[16] However, the operation of the Act had proved very satisfactory and, although the House failed to provide for the taxes in the Revenue Act of 1934, the Senate[17] added them to the Bill and they were re-enacted as a permanent measure.[18] The following year they were again re-enacted[19] for an indeterminate period, the major change being a realignment of the excess profits tax from 5 per cent. of the income in excess of 12½ per cent. of adjusted declared value, to 6 per cent. (12 per cent. in upper brackets) of the income in excess of 10 per cent. of the adjusted declared value. In addition this re-enactment permitted a restatement of the original declared value for the taxable year ending June 30, 1936.

The 1935 Act was not altered by Congress in 1936, except for minor changes,[20] and in 1937 no amendment whatsoever was made. Therefore, the following discussion will concern the Act of 1935, as amended in 1936.

(a) Capital Stock Tax

For each year ending June 30, there is a tax, on each corporation[21] doing business,[22] of $1 for each $1000 of the "adjusted declared value of the capital

11. REP. COMM. ON WAYS AND MEANS ON REV. BILL OF 1918 (Sept. 2, 1918) 16.
12. 40 STAT. 1088 (1919).
13. 77 CONG. REC. 5141 (1933); 372 C. C. H. 1937 Fed. Tax Serv. ¶ 1971.08.
14. See discussion of determining the "adjusted declared value", *infra* p. 92.
15. 48 STAT. 207 (1933). See Legis. (1934) 10 NOTRE DAME LAWY. 102.
16. N. Y. Times, Nov. 15, 1933, p. 3, col. 5.
17. 78 CONG. REC. 5847 (1934). Senator Harrison reports to the Senate that the Capital Stock and Excess Profits Tax had proven eminently satisfactory.
18. 48 STAT. 769 (1934), 26 U. S. C. A. § 1358 (1935); 48 STAT. 770 (1934), 26 U. S. C. A. § 341 (1935).
19. 49 STAT. 1017 (1935), 26 U. S. C. A. § 1358a (Supp. 1936); 49 STAT. 1019 (1935), 26 U. S. C. A. § 342 (Supp. 1936).
20. 49 STAT. 1733 (1936), 26 U. S. C. A. § 1358a (Supp. 1936); 49 STAT. 1733 (1936), 26 U. S. C. A. § 342 (Supp. 1936).
21. This Note deals only with domestic corporations. For foreign corporations and corporations set up under the China Trade Act there are slightly different provisions under the same taxing statute. See Waterhouse in *The Capital Stock Tax on Foreign Corporations* (1936) 14 TAX MAG. 76, who suggests that the only questions involving foreign corporations are (1) whether the corporation is carrying on business in United States, and (2) the value of the capital employed in the transaction of its business in the United States. U. S. Treas. Reg. 64, Art. 21, construes the term corporation to mean generally an association, joint stock company, and insurance company (which is not life or mutual insurance company). See 372 C. C. H. 1937 Fed. Tax Serv. ¶ 1939.
22. See Waterhouse, *The Capital Stock Tax* (1935) 13 TAX MAG. 595, for discussion of what is "doing business".

stock" of the corporation.[23] The adjusted declared value consists of the original declared value plus certain mechanical changes purportedly representing actual changes in the capital value of the corporation.

These mechanical changes are as follows. To the original declared value or, after the second year, to the adjusted declared value of the preceding year, the sum of the following items is added: (1) Cash or the fair market value of property paid for stock issued; (2) paid in surplus and contributions to capital; (3) the net income [24] of the corporation as computed for income tax purposes; (4) income wholly exempt from the income tax, such as interest from state bonds; (5) the aggregate amount of such dividends as are allowable as deductions from income for income tax purposes.[25] From this total there is then subtracted: (A) value of any property distributed to shareholders in liquidation or partial liquidation; (B) distributions made from prior or current earnings or profits; (C) the excess of valid deductions for income tax purposes over gross income where the income tax return shows a net loss.[26] These adjustments take place as of the close of the preceding income-tax taxable year.

(*b*) *Excess Profits Tax*

The excess profits tax is based upon the same adjusted declared value that was fixed on the corporation's capital stock tax return as of the end of its preceding income-tax taxable year. The Act provides that profits equal to 10 per cent. of the adjusted declared value shall be a normal return and shall not be taxed, but that there shall be a 6 per cent. tax on all income in excess of 10 per cent. of the value and not in excess of 15 per cent. of the value. Any remaining income is taxed at 12 per cent. Besides the 10 per cent. deduction, corporations are allowed a credit against net income of 85 per cent. of dividends received from other domestic corporations subject to taxation.[27]

An illustration will serve to show how the mechanical changes to the adjusted declared value affect the determination of the taxes. Assume a corporation which declared the value of its capital stock at $100,000 for the purpose of filing its capital stock return for the year ending June 30, 1936. It filed the income tax returns on a calendar year basis. During the calendar year 1936 the corporation has a net income for income tax purposes of $10,000 (including $600 in dividends from other domestic corporations subject to taxation); receives $500 as interest on state bonds; and $1000 as contributions to capital. It also issues 100 shares of stock for which it is paid $2000. The corporation paid out $2000 during the year in partial liquidation of an issue of stock. It also declared dividends out of earnings amounting to $9000. Assume that during the calendar year 1937 the corporation has a net income for income tax purposes of $17,000 (including $1000 in dividends from other domestic corporations subject to taxation). The corporation's capital stock taxes for the years ending June 30, 1936

23. See *infra* p. 92.

24. As to what constitutes "net income", see sections 21, 22, 23 of the Revenue Act of 1936, 49 STAT. 1657 (1934), 26 U. S. C. A. §§ 21, 22, 23 (Supp. 1936), and decisions therein collected.

25. The purpose of this provision under the Revenue Acts prior to 1936 was to take into account the increase in capital value as a result of dividends received from other corporations, since these dividends were not included in the net income figure for readjustment of declared value. However, as they are not included in net income under the 1936 Revenue Act this provision has no application to corporations filing under this Act.

26. This is a fair provision because a corporation may have a net loss in a single year and therefore the value of the corporation is diminished. However, in certain instances it causes inequities; see *infra* p. 94.

27. Section 26 (b) of the Revenue Act of 1936, 49 STAT. 1733 (1934), 26 U. S. C. A. § 342 (b) (Supp. 1936).

and 1937, and its excess profits taxes for the years ending December 31, 1936 and 1937, are computed as follows:

CAPITAL STOCK TAX—YEAR ENDING JUNE 30, 1936

Original Declared Value as of Dec. 31, 1935		$100,000.
Tax at rate of $1.00 for each full $1000 of value		100.

CAPITAL STOCK TAX—YEAR ENDING JUNE 30, 1937

Original Declared Value as of Dec. 31, 1935		$100,000.
Additions:		
(1) Total cash paid in for shares	$ 2,000.	
(2) Contributions to capital	1,000.	
(3) Net income for income tax year ending Dec. 31, 1936	10,000.	
(4) Exempt income from state bonds	500.	
(5) Dividend deduction allowable for income tax purposes	None	
Total		13,500.
		$113,500.
Deductions:		
(A) Total cash distributed in liquidation	$ 2,000.	
(B) Distribution of earnings	9,000.	
(C) Excess of deductions over gross income[28]	None	
Total		11,000.
Adjusted declared value as of Dec. 31, 1936		$102,500.
Tax of rate at $1.00 for each full $1000 of value		102.

EXCESS PROFITS TAX

Year ending December 31,	1936	1937
Original declared value as of end previous year	$100,000.	$102,500.
Net income for calendar year	$ 10,000.	$17,000.
Less 85% of dividends received from other corporations	510.	850.
Balance net income	$ 9,490.	$ 16,150.
Less 10% of adjusted declared value	10,000.	10,250.
Net income subject to tax	none	$ 5,900.
Amount taxable at 6% (15% of declared value minus 10% of declared value)	none	5,125.
Balance taxable at 12%	none	$ 775.
Tax at 6%	none	$ 307.50
Tax at 12%	none	93.00
Total Excess Profits Tax	none	$ 400.50

One problem respecting the application of mechanical amendments (1) and (A) to the adjusted declared value, centers in their effect upon corporations dealing in their own stock. The Treasury Department has issued a ruling that "the mere purchase of outstanding stock by the corporation which issued it effects no change in its capital structure. The subsequent sale of such stock by the corporation is likewise ineffectual to bring about any change. Ownership of the stock under such conditions is substantially the same as ownership of any other asset. Neither the purchase nor sale of such stock nor both of them combined warrant any change in the original declared value of the capital stock of a corporation under subdivision (1), or (A)." [29] However, in the same ruling it is

28. Deductions under this heading occur only when corporations show a net loss.
29. XIV-2 Int. Rev. Bull. 411 (1935).

stated, "Where a corporation acquires stock not for resale but for retirement a different rule applies . . . ." In that case the Treasury Department allows adjustment of the value on the basis of the liquidation of assets.

On the authority of the wording of the Act requiring "liquidation" for a deduction and in view of the other sections of the Revenue Act[30] defining liquidation as "complete cancelation or redemption" of the stock, the distinction between retired shares and treasury shares is justified as to requirement (A). Thus, it is reasonable for the Department to interpret the companion section (1) (referring to the increase of the declared value for money paid for stock) to mean only unissued (non-treasury) shares, a reversal of the process under (A). Certainly it seems that the federal government has not attempted to include authorized but unissued stock as a taxable corporate asset. Thus it follows that if such shares are not assets, their sale increases the value of the corporation by the entire proceeds of the transaction. It should be pointed out, however, that any net profit or loss made in the trading of its own shares by a corporation may be adjusted under other provisions for adjustment of the declared value.[31]

On the other hand, it may be argued that, for this purpose, no practical distinction between unissued shares and treasury shares should be made, that the latter are no more an asset than the former, and that, therefore, the value of the corporation does not remain static when shares are purchased for the purpose of resale. Actually it must be recognized that there is less earning power present in the corporation when shares have been repurchased, and correspondingly more earning power present after the shares have been resold. Of course, the Treasury ruling requires "retirement" before any deduction, but should that effect any change in the value of the corporation? The only conclusion to be drawn is that the interpretation is correct if the shares held for resale are considered to be assets. But in the sense that assets add to the income-earning power of the corporation, it would seem that such shares are not assets.[32]

II. *Estimating the Declared Value*

In determining the initial amount to be returned on the adjusted declared value, it should be noted that the purpose of allowing the corporation to set up arbitrarily its own tax base is to allow it to return what it feels is the value of the corporation in respect to providing earnings, including the intangibles and the "potentialities of growing rich".[33] Any valuation based on "actual value", "book value" or the like is always a subject of contention and is seldom a true picture of the corporation's ability to produce profit.[34] Consequently a method was devised to eliminate the continual bickering over values and yet to produce a picture of the corporation's worth sufficiently accurate to produce desired revenue based upon it. For this reason the excess profits tax was added as an appendage.[35] It was not expected to be a source of revenue except in the case of abnormal profits,[36] and it is significant to note that it has provided less than 10 per cent. of the revenue from these two imposts.[37]

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30. Section 115 (c), (i), 49 STAT. 1687 (1934), 26 U. S. C. A. § 115 (c) (Supp. 1936).

31. *Supra* note 29, at 412.

32. Judge Learned Hand, in Borg v. Int. Silver Co., 11 F. (2d) 147, 150 (C. C. A. 2d, 1925) says that they are not a present asset, but merely an opportunity to acquire new assets.

33. Gerstenberg, DECLARATION OF CAPITAL VALUES UNDER THE REVENUE ACT OF 1934 (Am. Management Ass'n, June 7, 1934) 5.

34. E. g., Ray Copper Co. v. United States, 268 U. S. 373 (1925).

35. HOW SHALL BUSINESS BE TAXED (Tax Policy League, 1937) 51.

36. REP. SEN. COMM. ON FIN., SEN. REP. No. 115, 73d Cong., 1st Sess. (1936) 6, 7.

37. See REP. SEC'Y TREAS. (1936), showing that in 1934 the capital stock tax brought in $80,168,344.13, and the Excess Profits Tax $2,630,615.50; in 1935, $91,508,121.29, to $6,560,-482.64; and in 1936, $94,942,751.74, to $14,509,290.47.

An important feature of this phase of the Act is that once the value is declared, it may not be amended. This was of no practical importance previously, because re-enactment of the tax permitted restatement of the adjusted declared value,[38] but since 1936 there has been no opportunity for such readjustment. This, coupled with the fact that the chairman of the Senate Finance Committee, in allowing restatement by the 1935 Revenue Act, recognized a possibility of unfairness in the prohibition against amendment,[39] portends that an amendment or restatement will be permitted at frequent intervals.

The declaration of value by a large corporation may be a very serious thing, for if it fixes too high a value, it must pay an excessive capital stock tax; if too low, it will pay an unnecessarily high excess profits tax. For example, assume that a corporation which represents an actual investment of $1,000,000 calculated either by the fair market value of the corporation or its average past income capitalized at 10 per cent., declares a value of $1,000,000 for the capital stock tax and earns $200,000 net income. The tax is as follows:

Capital stock tax of $1.00 for each full $1000 of declared value ...	$ 1,000
Excess profits tax:	
10% of $1,000,000 exempt ($100,000)	
6% of $50,000 (15% of declared value minus 10% of declared value)	3,000
12% of remainder ($50,000)	6,000
Total Tax	$10,000

It is clear from this example that estimated future earnings are a most important consideration.[40] If the corporation had based its declared value on its estimated future earnings, which ordinarily would have been at least partially forseeable, it would have been able to advance its adjusted value to some median point which would have resulted in its paying a somewhat higher capital stock tax but a much lower excess profits tax. Thus, it is evident that a value estimated entirely on present actual worth or past earnings may result in the payment of an unnecessarily high tax. The rate at which the excess profits tax mounts is correspondingly higher and steeper than the capital stock tax rate, so that in case of inability to calculate future earnings the capital stock should always be declared higher rather than lower.

As business conditions change so rapidly, it would seem impractical at first blush to use an estimate of future earnings as a base for the declared value. However, this appears to be the only method to reach an adequate valuation. Charles Gerstenberg[41] evolved a formula for setting up the basis under the old single bracket tax of 1933. This was premised entirely upon estimated future earnings and suggested choosing the highest estimated yearly earnings for the succeeding six years and multiplying that sum by eight. The general idea was to take as a cycle the number of years it would require to remedy a mistake, whereby too great an excess profits tax was paid, by a corresponding saving on the capital stock levy. Capitalizing on the highest earnings of any one year by multiplying by ten (10 per cent. being percentage of tax free return under the present tax) would eliminate any excess profits tax, although possibly as much would be paid in capital stock tax over the period of the cycle. Since the purpose of the levies is to tax the capital stock, and it is impossible to avoid both taxes, this seems to be a

38. It was felt that once the value was stated it would never be permitted to be restated. See *Washington Tax Talk* (1933) 11 TAX MAG. 262. However, out of administrative convenience and not beneficence Congress allowed restatement several times. Nelson, N. Y. Times, June 17, 1934, § 2, p. 9, col. 3. See advice by N. Y. Bd. of Trade, *supra* note 2.

39. 78 CONG. REC. 5847 (1934).

40. See Gerstenberg, *op. cit. supra* note 33; Nelson, *The New Capital Stock Tax Imposed by the National Industrial Recovery Act* (1933) 42 ANNALIST 309.

41. Gerstenberg, *op. cit. supra* note 33.

feasible approach. However, Gerstenberg's formula was based on the single bracket tax and would not be accurate for the present double bracket tax. Apparently no certain formula has been devised for our present type of tax, but the general theory upon which Gerstenberg's formula rests seems to provide a working basis for estimating the adjusted declared value.

The ever present possibility that the tax will be terminated [42] should be given weight in determining whether or not to capitalize on the basis of the income of the highest future year. For, in the event that the tax ends before the business cycle used in estimating the future income ends, a higher capital stock tax will be paid without the attendant immunities from excess profits levies.

III. *Validity*

The reappearance of the taxes in 1933 was treated by tax experts and economists with inconsistent views. It was labeled as "the ghost of war years",[43] "the bugaboo of corporations and the delight of accountants and lawyers".[44] On the other hand authorities said such things as "these taxes promise to be the most successful and most satisfactory of any which have been adopted. They offer immediate and complete certainty and almost no administrative difficulty." [45] Others not only welcomed the tax but declared that it was not sufficiently high.[46] To which of these views one should subscribe depends greatly upon his economic and political doctrine. Certainly from the point of view of the government the tax was successful in harvesting the estimated revenues.[47]

The tax does result in one great inequality; the corporation with greatly fluctuating profits and losses is penalized heavily. Consider corporations whose income is dependent upon weather conditions, or, as in the case of cotton cloth manufacturers, upon the vagaries of fashion. In these cases there may be a loss in one year or in a series of years, offset by a large profit in another year. Thus in the course of a business cycle such corporations may show a net profit the same as that of corporations with a more stable market, yet pay a greater excess profits tax.

For example, assume two corporations each with a value of $1,000,000 based upon either a fair market value or the average net income for several years capitalized at 10 per cent. Accordingly, each corporation declares a value for tax purposes of $1,000,000. Corporation *A* earns $100,000 annually and therefore pays only $1000 in capital stock tax and no excess profits tax; the declared value remains constant without adjustment because all income is distributed and there are no deductible losses.

On the other hand Corporation *B* in 1936 suffers a net loss of $200,000 but in 1937 reaps a net income of $400,000 of which $200,000 is distributed. Thus, at the end of the two-year period the shareholders of each corporation are in exactly the same position insofar as return upon their investment is concerned. But Corporation *B* pays a much higher tax. For the year 1936 Corporation *B* pays a $1000 capital stock tax because it had declared $1,000,000 value. Then it

42. President Roosevelt in his message to Congress in 1936 recommended the abolition of the capital stock and excess profits taxes. H. R. Doc. No. 418, 74th Cong., 2d Sess. (1936) 3.

43. *Washington Tax Talk* (1933) 11 TAX MAG. 262.

44. *Ibid.* See HOW SHALL BUSINESS BE TAXED (Tax Policy League, 1937) 62.

45. Baar, *Valuation of Capital Stock for Federal Stock Tax* (1933) 11 TAX. MAG. 259. This writer is the co-author of HIDDEN TAXES IN CORPORATE REORGANIZATION (1935) and an outstanding authority on federal taxation.

46. See KING, PUBLIC FINANCE (1935) 353; W. C. Moore, economist, in N. Y. Times, May 21, 1933, § 2, p. 16, col. 1, saying that corporations are still making excessive profits upon their invested capital and that these should be reached by some such system of taxation.

47. N. Y. Times, June 3, 1933, p. 5, col. 2; *id.* June 4, 1933, § 1, p. 1, col. 6; *id.* July 24, 1934, p. 25, col. 1.

suffered a net loss which under the Act is mechanically subtracted from the prior declared capital stock. Therefore, the adjusted declared capital stock value for 1937 is $800,000. The corporation pays $800 capital stock tax for that year but is entitled only to a 10 per cent. return without paying a further tax, i. e. $80,000. However, the corporation made $400,000 this year. This was really a recuperation of the $200,000 loss of the previous year and the $200,000 net income which can be looked upon as representing $100,000 profit for each of the two preceding years. Therefore $320,000 is subject to an excess profits tax. Of this sum $40,000 falls within the 6 per cent. bracket of the excess profits tax and calls for a levy of $2400; the remaining $280,000 lies within the 12 per cent. bracket and is therefore subject to a tax of $33,600. The total tax for Corporation *B* in 1937 is $37,000 whereas the total tax for Corporation *A* is $1000.

This inequality, however potentially great, does not loom large through the business world, for, from the figures previously cited,[48] it is evident that in general very little is paid in excess profits tax. These inequalities in themselves should not invalidate the tax as being arbitrary and discriminatory in bearing more heavily on one corporation than on another. Similar situations may arise under any graduated tax, especially under the income tax, and that tax has not been invalidated on the ground of inequality.[49]

It has been recognized that for administrative purposes a tax must be applied on a fixed period basis,[50] and therefore certain inequalities are bound to result where the entire income cycle does not correspond with the taxable period. This was pointed out forcibly in *La Belle Iron Works v. United States*,[51] which involved the war income taxes. In that case the Court declared that "the difficulty of adjusting any system of taxation so as to render it precisely equal in bearing is proverbial. . . ." [52] The Court then pointed out that the Act treats all corporations alike in its terms and that, if in its application it bears more heavily on one corporation than on another, it is because of circumstances and not because of any uncertainty or want of generality or arbitrariness in tests applied.[53] In the case of the excess profits tax a corporation may in some measure protect itself by carefully estimating its future income, where that is possible, in computing declared value, whereas in the case of the income tax there is not this possibility of protection.

Obviously these inequities would not prevail if corporations could amend their adjusted declared value to take care of the fluctuations. It is on this ground that the Act is being challenged in the courts.[54]

Inasmuch as restatement of the declared value has been permitted three times there has been little occasion to litigate the question, and no clear case has arisen to test directly the constitutionality of the clause prohibiting amendment. However, in *Oertel v. Glenn* [55] the problem was treated by the court and decided in favor of the taxpayer, allowing an amendment within the time

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48. See *supra* note 37.
49. Brushaber v. Union Pac. R. R., 240 U. S. 1, at 25 (1916).
50. See Burnett, Comm'r v. Sanford, 282 U. S. 359, 365 (1931).
51. 256 U. S. 377, 392 (1921).
52. *Ibid.*
53. *Cf.* Stewart Dry Goods Co. v. Lewis, 294 U. S. 550 (1934), where a tax on the sliding percentage of *gross* sales was held invalid as discriminatory and arbitrary. The Court distinguishes cases of net income, *id.* at 558.
54. E. g., Scaife & Sons v. Driscoll, 18 F. Supp. 748 (W. D. Pa. 1937). The capital stock tax was also attacked as being invalid by a corporation whose business was confined to the exportation of goods, and which claimed that the Act was, as applied to it, a tax upon exports and therefore prohibited by U. S. CONST. Art. I, § 9, cl. 5. In a decision without opinion, the tax was upheld in National Paper and Type Co. v. Bowers, 270 U. S. 630 (1925).
55. 13 F. Supp. 651 (W. D. Ky. 1936), now being appealed in C. C. A. 6th.

for filing the excess profits tax return.[56] Limited to its facts the case is of little importance, since most corporations will be able to set a value that will enable them to pay a minimum tax for the first year. However, the implication from the case would allow a refund of the capital stock or excess profits tax paid, based upon refusal by the collector to allow amendments at the time of the return of the tax, if it were shown that conditions had so changed as to render the tax base valuation an untrue reflection of the actual value.[57]

Accordingly, it would be well to examine this case with a view to considering those implications. The court states that "if the statute authorizes an arbitrary determination [of the value] it would be void for uncertainty." [58] It amplifies this by declaring that a ". . . statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the Fifth Amendment." [59] No quarrel may be made with this latter principle as such, but its application to the instant case is not clearly establishel by the court. The cases cited in support of its conclusion involve criminal statutes which in their terms are not clear because by reading the statutes a person would not be able to determine what standard of conduct was required of him. Such is the uncertainty which invalidates them. But in the case of the capital stock and excess profits tax the statutory provisions are clear; each corporation having determined its declared value, can compute the tax required of it. The only uncertainty in the Act lies in the arbitrary declaration of value, but this is not that type of uncertainty inherent in the words of the statutes which were invalidated in the cases cited by the court. This is so since the taxpayer is clearly able to apply the words of the statute and determine the required tax.

The court further states that the measure of the tax being "value" must mean "actual value based upon facts", and that otherwise the Act is violative of the Fifth Amendment. This might well be true if the tax were based on the "value" of the capital stock, but the court failed to note that the statute calls for a *"declared* value" base.[60] This squarely places the estimation of the "value" entirely upon the taxpayer, and there is no need to look further for the legislative intention.

Although the tax does not seem to be invalid for lack of provision to amend the declared value in the case of changes (not covered by the mechanical adjustments) in the earning power of corporations, yet provision for amendment might well alleviate the burden of inequality. In the light of constantly changing business conditions, it would be fair to limit the penalty of a bad guess as to future income to a three-year period. This would effectuate to a great extent the purpose of the present Act to prevent the average corporation from restating its value with every annual shift of business conditions.

L. W. F., Jr.

56. Subsequent to the time of this controversy with the collector, the Department ruled under date of Sept. 17, 1933, that no return could be amended before expiration of time for filing the return, 11 TAX MAG. 359 (1933). The case resulted in allowing such an amended return.

57. 373 C. C. H. 1937 Fed. Tax Serv. ¶¶ 5250, 5254.

58. Oertel v. Glenn, 13 F. Supp. 651, 653 (W. D. Ky. 1936).

59. *Ibid.*

60. *Ibid.*