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EXAMPLES ILLUSTRATING THE NECESSITY OF HIGH TAX RATES ON UNDISTRIBUTED EARNINGS

If the corporation income tax is to be retained the risk of loss of revenue will be avoided and there will not be the possibility of large windfall gains accruing to stockholders of corporations which distribute substantially all their earnings. Rates under the supplementary undistributed profits tax, however, must be drastic enough to accomplish the purpose of bringing income within the reach of the personal income surtax. The rate schedule reported as having been proposed by Chairman Harrison is not drastic enough.

The following table summarizes Senator Harrison's suggested schedule as reported in the newspapers:

Percentage of adjusted net income undistributed (before undistributed profits tax)		Tax rate applicable to additional part of net income undistributed	Total tax as a percent of adjusted net income
	Under 30	No tax	
30			0
	30 - 35	5 percent	
35			0.25 percent
	35 - 40	12½ percent	
40			0.875
	40 - 50	20 percent	
50			2.875
	50 - 60	30 percent	
60			5.875
	60 - 70	45 percent	
70			10.375
	70 - 100	45 percent	
100			23.875 1/

1/ Maximum possible tax.

During four years of prosperity a mere dozen of large corporations 1/ paid out only $174,000,000 of a sum of $565,000,000 available for common dividends. Nearly $400,000,000 escaped surtaxes, and surtaxes in the higher brackets would have been levied on the bulk of this amount.

TABLE I

Income and Dividends of Twelve Selected Corporations

(Millions of dollars)

	4 yrs. 1926-29	4 yrs. 1930-33	2 yrs. 1934-35
Consolidated net income after Federal taxes	665	332	205
Preferred dividends (and minority interests)	100	96	51
Available for common	565	236	154
Common dividends	174	211 1/	84
Undistributed earnings	391	25 1/	70

1/ Five of these twelve corporations paid common dividends in excess of the amount currently earned for the common stock in either one or two of these years. None paid common dividends out of accumulations in more than two of these years.

The table shows that these twelve corporations as a group earned $1,200,000,000 in the ten years 1926-1935. They paid $250,000,000 in preferred dividends, but out of the remaining $950,000,000 they distributed

1/ Aluminum Co. of America
American Smelting & Refining Co.
Coca-Cola Co.
Colgate-Palmolive Peet Co.
Continental Baking Corp.
Great Atlantic & Pacific Tea Co.
Gulf Oil Corp.
Hershey Chocolate Corp.
Koppers Gas & Coke Co.
S. S. Kresge Co.
Procter & Gamble Co.
Radio Corporation of America

only $470,000,000, or about half, in common dividends. It also shows that these corporations did not need to draw on their accumulation of earnings in order to maintain dividends in the depression years. Their combined earnings continued to be sufficient to allow the accumulation of a substantial amount even in these years.

The figures used in the table are taken from public reports and probably understate the taxable adjusted net income of these corporations. And there are many other corporations like these. The record therefore clearly shows that large amounts of income in the hands of large corporations have escaped surtaxes in prosperous years and are escaping them at the present time.

The proportions of income retained by these corporations varied from year to year but also varied more between one corporation and another. Examples are cited here to show this proportion in three individual cases and also the tax which Chairman Harrison's schedule would have imposed.

Radio Corporation of America paid no common dividends throughout these ten years. The percentage of net income retained after preferred dividends during the years 1926 to 1929 varied between 93 and 65 and aggregated $39,000,000 out of total net income of $49,000,000. In the next four years net income totalled $5,000,000 and surplus was drawn on for an additional $6,000,000 to pay preferred dividends. Undistributed earnings taxes would have been assessed at a maximum rate in the year 1928 equivalent to about 21 percent of net income.

American Smelting and Refining Company paid both preferred and common dividends but its total disbursements, 1926-1929, were only about half of its net income. $37,000,000 was retained and this was 63 percent of the amount available for the common stock. This proportion did not vary much from year to year. The tax rate under Chairman Harrison's schedule would have amounted to about seven percent on net income, though about 11 percent on total undistributed earnings and 45 percent on the amount of undistributed earnings in the highest bracket.

Continental Baking Corporation retained only from 15 to 39 percent of its net income in the years 1926 to 1929 and would have been subject to an insignificant tax in one of these years. Nevertheless most of its distribution was to cover the more or less fixed charge of preferred dividends. In 1926 it disbursed most of the amount remaining available for common dividends, but in 1927 only about half of it, and in 1928 and 1929 it paid no common dividends at all. In 1929 a tax of less than 1 percent of its net income would have been assessed, and none in the other years.

Three of the corporations included in the group of 12 are owned by the Mellon interests. As shown in the following table, during ten years their net income amounted to at least $258,000,000. After preferred dividends of $80,000,000 at least $178,000,000 was available for distribution to the common stockholders. $45,000,000 was the amount of common dividends paid.

TABLE 2

Net income on undistributed profits of 5 Mellon companies (Millions of dollars)

	1926-29 1/	1930-1933	1934-1935
Net income	218	5	35
Preferred dividends	40	30	10
Available for common	178	-25	25
Common dividends	27	15	1
Undistributed profits	151	-40	24

1/ Excluding in 1926 and 1927 Koppers Gas & Coke Co., not yet formed. The other companies are Aluminum Co. of America and Gulf Oil Corporation.

It is apparent that the rates proposed by Senator Harrison would be ineffective in forcing out any additional appreciable amount of dividends. Personal incomes in excess of $74,000 are subject to surtax rates ranging from 47 to 75 percent. The highest rate in Senator Harrison's proposed schedule is 45%. Since it is a fair assumption that individuals dominating large corporations have incomes in excess of $74,000, it follows that they would find it personally advantageous to continue to leave earnings undistributed with corporations.

The fact that in so doing they would victimize small stockholders cannot be relied upon as an effective check, if for no other reason than that small stockholders will not know the high rates paid. Taxes will be shown in a lump sum as heretofore, and the rate paid if 60% of earnings are retained amounts only to 5.9 percent of adjusted net income. The only way in which justice for the small stockholder can be obtained is by making the rate on undistributed earnings so high that wealthy stockholders will no longer find it to their advantage to have earnings retained.