

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date May 23, 1936.

To Chairman Eccles
From Lauchlin Currie
LC

Subject: _____

Attached is a brief statement of objections to the
Senate Committee's tax proposals.

May 23, 1936.

OBJECTIONS TO THE SENATE COMMITTEE'S TAX PROPOSALS

The enactment of the Senate Committee's tax proposals would, (1) penalize small corporations, (2) make the cost of the corporate form of enterprise well-nigh prohibitive for small business men, (3) (4) constitute a departure from the principle of taxing according to ability to pay, (5) permit wealthy stockholders to continue to evade their fair share of taxation, (6) favor rather than check the growth of uneconomic bigness, (7) be ineffective in forcing more purchasing power into circulation.

The position of owners of small corporations would be adversely affected ~~because~~ ~~in several ways. In the first place,~~, the corporate income tax would be raised from 12 1/2 percent to 18 percent, as compared with only a 3 percent increase for large corporations. If, owing to their lack of access to the capital markets, small corporations retained earnings for debt retirement purposes or for expansion, they would be subject to an additional tax of 7 percent, or 25 percent in all, as contrasted with 12 1/2 percent now. If they distributed earnings as dividends, the owners would have to pay a 4 percent normal personal income tax, or 22 percent in all. ~~It is clear that~~ Such a tax, besides being unjust, would practically deny the benefits of incorporation to thousands of small business men, would lessen competition and encourage the growth of large corporations.

The income of stockholders in corporations retaining earnings would ~~will~~ be subject to 10 percent more in taxes than under existing law (increase from 15 to 18 percent in the corporation income tax plus 7 percent). This is very much less than the surtax rates ~~that would~~ apply to the incomes of many wealthy stockholders if earnings were distributed in dividends, but very much more than stockholders with low incomes now pay. Consequently our tax system would be graduated downward rather than upward, contrary to the accepted principle of taxation in accordance with ability to pay.

Furthermore, the rate of 7 percent applicable to undistributed earnings is so low that it would continue to be in the interest of wealthy stockholders to leave earnings undistributed with corporations. Since dividends would be subject to the 4 percent normal tax, the additional penalty upon retaining earnings would be only 3 percent, as against much higher surtaxes that would have to be paid if the income were distributed. This means that nothing would have been accomplished in closing up the loophole through which the wealthy evade surtax rates. Consequently there would be no impetus to the disbursement of accumulating idle corporate balances, to the flow of purchasing power, or to the recovery movement.

~~Many of these objections could be overcome by (a) retaining the present structure of the present principle of graduation in the corporation income tax, (b) increasing the exemption from the undistributed earnings tax to \$15,000 and (c) imposing a sufficiently high rate on undistributed earnings to yield sufficient revenue and force increased distribution of earnings.~~

In order to overcome just ~~just~~ objections I previously proposed: (1) Retention of the present corporate tax structure, (2) Exemption of some 1/5 now to relieve small corporations which comprise 90 per cent of the total, (3) a rate of 8 per cent on ~~plus~~ earnings held back to meet debt and statutory obligations, (4) a sufficiently high rate on undistributed earnings to induce corporations to pay them out to stockholders. ~~so that they could~~ taxation would not be ~~escaped~~ escaped.