Despres
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# ALTERNATIVE EXCESS PROFITS TAX PROPOSALS

## The Treasury Proposal

Under the Treasury proposal, the framework of the existing excess profits tax statute would be substantially retained, with the exception that the percentage of past average earnings allowed in computing the earnings base would be lowered to 75 per cent from its present level of 95 per cent. This amendment should yield about $400 millions in calendar year 1942, on the basis of estimated 1941 corporate earnings. Moreover, with rate schedules and other provisions of the existing excess profits tax law substantially unchanged, the additional yield resulting from this single amendment would not grow significantly in later years as national income expands. By reducing the portion of base-period earnings to be deducted in computing excess profits, this change increases a corporation's taxable excess profits by a constant amount each year. If accompanied, however, by a revision of the rate schedule which would increase the maximum rate to 75 per cent on taxable excess profits over $45,000, the proposal would provide an estimated yield in calendar year 1942 of $650 millions on the probable earnings of calendar year 1941.

## President's Proposal

The President's alternative proposal establishes a uniform excess profits base of 6 per cent return on invested capital. A tax rate of 10 per cent is applied to earnings between 6 and 7 per cent of invested capital; a rate of 20 per cent on earnings between 7 and 8 per cent; and the same scale of graduation is continued until a rate of 100 per cent is reached on earnings in excess of 15 per cent. Making the somewhat unrealistic assumption that the imposition of a 100 per cent rate on profits above 15 per cent would not reduce the volume of taxable excess profits by weakening the incentives to keep down costs, this proposal would yield $1 billions more revenue in calendar year 1942 than the existing excess profits tax. The revenue yield of this proposal would rise sharply as national income increases. Most of the additional revenue would be obtained from corporations earning a very high rate of return on invested capital. The following table shows the effective rate of taxation of excess profits, and the net rate of return after all taxes, for corporations earning specified rates of return before excess profits tax:

| Rate of Return on Invested Capital | Effective Rate of Tax on Excess Profits | Net Rate of Return after Tax |
|---|---|---|
| % | % | % |
| 6 | 0 | 6 |
| 8 | 15 | 7.7 |
| 10 | 25 | 9.0 |
| 12 | 35 | 9.9 |
| 15 | 50 | 10.5 |
| 20 | 68 | 10.5 |
| 30 | 81 | 10.5 |
| 50 | 90 | 10.5 |

The above table indicates that the effective rate of tax for many corporations earning between 8 and 15 per cent on invested capital would be lower than under the existing statute. The effective rate on corporations earning between 6 and 8 per cent of invested capital is so low that the additional revenue obtained from this group of corporations would be comparatively unimportant. It follows that the corporations earning above 15 per cent on invested capital would provide the bulk of the additional revenue to be derived from this proposal. Consequently, the additional revenue yield would be sharply reduced if the proposed rate schedule were significantly moderated. Perhaps the most significant effect of the tax would be to establish a ceiling of 10.5 per cent for corporate earnings after tax, whatever the rate of return before tax.

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