Form F. R. 131

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date August 5, 1942.

To Chairman Eccles

From Martin Krost

MK

Subject: Tax Treatment of Corporations Reporting on the Fiscal Year Basis

We find that the change in the treatment of fiscal year corporations provided for in the House version of the tax bill was not proposed by the Treasury but originated in the technical staff of the House Ways and Means Committee. The Treasury expressed some opposition to the change and will probably continue its opposition during the consideration of the bill by the Senate Finance Committee.

In response to your request I am briefly summarizing the arguments for and against the change. On balance these arguments seem to indicate that it is undesirable to make the change at the present time. A more detailed memorandum is available if you would like to see it.

1. Yield considerations.

For the change: Tax liabilities on 1942 corporate incomes would be increased by about 250 million dollars.

Against the change: It is not at all certain that the change will increase Treasury revenues over a long period of years. It may actually lower tax yields. Whether it raises or lowers them depends upon how long the war lasts and how drastically corporation tax rates and corporate incomes decline after the war.

2. Equity considerations.

For the change: In the long run and as a general proposition it is more equitable for all corporations to pay taxes at the same rates and under the same tax laws on their earnings over the same period of time.

Against the change: If the change is introduced during a period of rapidly changing rates and incomes the change may increase, rather than reduce, inequities until rates and incomes have become more stable again. For example, if the change is made just at the time that rates and incomes stop rising and begin to fall, fiscal year corporations that have benefitted from the lag in the application of increasing tax rates to their incomes on the "up" side would by shifting to a calendar year basis profit by the prompt application of decreasing tax rates to their incomes on the "down" side. In the light of these considerations the case for the change would have been stronger in 1938 than it is now.

3. Economic effects.

For the change: It will increase tax collections during the war period.

Against the change: The funds which would go to pay taxes if the change was made are most unlikely to be spent on goods and services if left in the hands of corporations. They will be invested in tax anticipation certificates, held as idle cash, or used in other non-inflationary ways.

4. Considerations of Convenience to Taxpayer and Treasury.

There are no arguments in favor of the change on the grounds of convenience. Convenience was the major reason that the present procedure was substituted in 1934 for the method reintroduced under the House bill. Corporations on fiscal year basis would have to compute tax liabilities on the earnings of their fiscal year under the provisions of two different laws. Corporations with a fiscal year ending on June 30 would not be in a position to determine their tax liability at the close of their fiscal year; they would have to wait until the passage of a new revenue act in September or October. Insofar as corporations would be forced under pressure of these difficulties to shift their tax year to the calendar year basis, the advantages of having the accounting year correspond to the "natural" operating year would be lost. The slight tendency of recent years toward the use of a fiscal year basis would be reversed. The seasonal pressure upon the accounting profession between December 31 and the March 15 tax date would be greatly increased. There would be a similar increase in seasonal pressure upon the Treasury as well as an increase in its job of checking the computation of tax liabilities.