BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date December 11, 1943

To Chairman Eccles

From Mr. Thomas Jr. T.
Mr. Musgrave R. A. M.

Subject: Treasury Meeting on Tax Incentives, December 9, 1943.

The meeting was attended by some fifty people, mostly economists from almost every Government department and agency. Randolph Paul, Ganson Purcell, Ben Cohen and Pritchard were among those present. The meeting was the first in a series of discussions intended to examine various aspects of tax reform which would be possible in the postwar period, with emphasis on business taxation. The discussion was rambling and elementary, and little effort was made to direct it toward any conclusions.

Discussion dealt principally with some of the major defects of the corporation income tax, such as the double taxation of dividends, the discrimination against equity capital, and the avoidance of personal income taxation through retention of profits. There was general agreement that the corporation income tax should be revised to minimize deterring effects on business. One approach would be to consider the corporation tax merely as a device for collecting the individual income tax at the source and to find a way of taxing undistributed corporate income to the individual. Another approach would be to accept more or less the present status of the corporation income tax, but to introduce certain changes which would minimize its deterring effects. Both approaches were considered, but no preference between the two was expressed. Some of the more interesting points raised were the following:

Mr. Colm suggested that an incentive to business spending might be given through a corporation tax which would tax idle business funds only. The tax base would be measured by the sum of profits and depreciation and depletion minus the amounts invested or distributed as dividends. A corporation which spends all of its income, either through distribution as dividends or through investment (maintenance of old, or investment in new, capital), would thus pay no tax. While this approach would not solve the problem of reaching the undistributed income under the individual income tax, it offers an interesting suggestion for a tax on "hoarding" by corporations.

Mr. Cohen suggested that if tax rates are high and provisions for loss deduction are liberal, large corporations might be willing to undertake risky ventures more or less independent of their main source of income knowing that possible losses from such side activities can be offset against the more certain income derived from the main line of business. A small corporation is at a disadvantage in this respect, since it does not have sufficient "certain" income against which to offset possible losses.

Mr. Paul announced that a further meeting would be called soon and that an outline of the topics to be discussed would be distributed in advance. The emphasis on the corporation income tax is well placed since the taxation of business will undoubtedly be the crucial factor in postwar tax reforms. A survey of the main problems involved is being prepared for your information by Musgrave.