TAX ON SURPLUSES TO SPEED DIVIDENDS

Wall Street Looks for Rush of Special Disbursements to Escape Assessment.

HEAVY LEVY UNDER LAW

Surtax 25% on Incomes Below $100,000; 35% Above—Bankers Criticize Act.

Special dividend payments by several large corporations in the last month have resulted partly from the fear that a levy may be assessed against them under the provision of the Revenue Act of 1934, according to Wall Street opinion. This provision calls for a surtax on corporations which have accumulated unreasonably large surpluses.

Directors of several companies have been discussing the advisability of distributing part of their surpluses to stockholders within the next few months, it is understood, owing to the fear of this surtax, which is described in Section 102 of the Revenue Act. This section states:

There shall be levied, collected and paid for each taxable year upon the adjusted net income of every corporation (other than a personal holding company as defined in Section 351) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting gains and profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

(1) 25 per cent of the amount of the adjusted net income not in excess of $100,000, plus

(2) 35 per cent of the amount of the adjusted net income in excess of $100,000.

Tax Never Invoked.

Although similar penalties have been set up in the revenue acts of the last twenty years, the undistributed surplus tax has virtually never been invoked except in the case of "family" or holding corporations, which were formed to enable individual stockholders to avoid the surtaxes on their personal incomes.

Reports that the Bureau of Internal Revenue may now seek to impose the undistributed surplus tax on all types of corporations has led to uneasiness among directors. Directors of concerns which have paid special dividends say that they have been motivated by a desire to aid stockholders and contribute to the recovery of business by putting idle money in circulation.

The tax on undistributed surpluses as applied to industrial corporations owned by thousands of stockholders has been criticized severely recently by bankers and tax authorities in Wall Street. They hold that the accumulation of surpluses is a conservative and necessary policy and that it has enabled corporations to survive periods of depression. Many corporations drew upon their surpluses to maintain dividend payments during the depression, while others escaped bankruptcy through the accumulation of reserve funds in prosperous years, it is pointed out.

Unwise Spending Feared.

If the surplus tax is invoked, bankers fear corporations may be encouraged, instead of distributing the funds to stockholders, to embark on unwise expansion of plants and the accumulation of inventories, since they might escape the levy by converting the surplus into other assets which ostensibly are necessary for the carrying on of the business.

Any corporation with accumulated surplus may be subject to the undistributed surplus tax under a recent Treasury Department decision (No. 4470), according to J. L. Amberg, economist, of Harriman & Co., members of the Stock Exchange:

"In this decision," Mr. Amberg said, "it is specified that an accumulation of gains or profits including the undistributed earnings or profits of prior years is unreasonable if they are not required for the purpose of the business considering all circumstances of the case. Theer is no attempt to enumerate all the ways which gains or profits of a corporation may be held for reasonable needs, but distributions may, shortly after the close of the taxable year, be taken into consideration in determining the reasonableness of earnings and profits as accumulated by a corporation. Incidentally, undistributed income, if invested in increased inventories or additions to plants, reasonably needed by the business, are allowed. The same applies to accumulation retained for working capital, particularly if placed to the credit of a sinking fund for the purpose of retiring bonds.

See Plan to Escape Tax.

"Among other things, it is stated that the financial condition of the corporation and the manner in which funds are invested determine the reasonableness of the accumulation. It is explicitly stipulated that the nature of the investment of said gains or profits is immaterial if they are not, in fact, needed for the business, and it is now held that the unreasonable accumulation of gains or profits by a corporation constitutes prima facie evidence of the purpose to enable its shareholders to escape the imposition of surtaxes.

"While the above statement as to specifications in Treasury Decision 4470 may be reasonably clear, it is evident that there could properly be an accumulation of surplus in order to be prepared for all commercial eventualities. It may even be that where there are bonds extant, surplus could properly be held so that said bonds might be retired in due course."