'SURPLUS' TAX HELD THREAT TO BUSINESS

Uncertainty of Its Application Menaces Conservatism, G. N. Nelson Contends.

PROVISIONS NOW EASED

Treasury Is Seen Weighing Reasonableness of Operating Units' Accumulations.

By GODFREY N. NELSON.

Recognizing the futility of the Treasury's endeavors to enforce generally the so-called undistributed surplus tax in the form enacted in revenue laws preceding the 1934 act against all corporations possessing large accumulations of earnings, the House Ways and Means Subcommittee, while engaged in the investigation of methods for the prevention of tax avoidance, recommended that the provisions of Section 104 of the 1932 act, imposing a tax upon accumulated profits, be divided into two distinct parts. It was proposed that one part deal with personal holding companies and the other with all other corporations which had accumulated unreasonably large surpluses.

Under the earlier acts the main test of applicability of this tax, as to both holding and operating companies, was whether the accumulations of earnings had been made with intent to prevent the imposition of surtaxes upon shareholders. Seeking to remove the burden of proving "intent" in the case of holding companies, and looking to impose a tax upon them which could be more or less automatically levied, a new section (Section 351) was written into the 1934 Revenue Act. This new section, re-enacted in the 1935 act with modifications, affects corporations whose income is derived principally from investments and whose stockholders are limited in number or confined to members of a family.

Section 104 of the 1932 Act was re-enacted in the 1934 Act (Section 102), except as to rates and some administrative amendments. The rates were reduced from a flat 50 per cent of net income, as defined by Section 104, to 25 per cent of the "adjusted net income" of the first $100,000 and 35 per cent thereof in excess of $100,000, by Section 102 of the 1934 Act. These are in addition to the regular corporation income tax. Having dealt separately with holding companies, the re-enacted section became effective only as to "operating companies" and such other corporations as will escape the category of a "holding company."

Agents Now Sifting Surpluses.

Despite past official assurances that in its application to operating companies the Treasury will not impose the tax upon accumulations reasonably necessary for the regular conduct of a corporation's business, the fact that revenue agents are now examining into surpluses with particular reference to dividend disbursements, earnings and their availability for distribution, while not in itself inimical, will naturally give rise to some measure of apprehension.

Although corporations have been required by statute to furnish specific information upon accumulated profits "when requested by the Commissioner or any collector," the Treasury regulations have administratively narrowed this authority to the Commissioner, "or any collector upon direction from the Commissioner." Not only has this restrictive regulation been in effect removed, but as to information on profits declared as dividends, heretofore required by statute to be furnished only when requested by the Commissioner, as well as to statements of accumulated profits, the Commissioner has authorized agents in charge as well as collectors to demand such information.

In a formal notice dated Sept. 26 the commissioner authorized collectors of internal revenue, and general and special internal revenue agents in charge, "as the representatives of the commissioner." to require from corporations information as to earnings which have been declared as dividends and as to earnings which have been accumulated and not distributed. The conferring of this general authority appears significant of a purpose to generally inquire into the reasonableness of surplus accumulations of operating corporations.

A Threat to Careful Concerns.

So long as the tax upon surplus of corporations actively engaged in productive business remains effective it is, by reason of its uncertainty of application, a threat against conservative business management. Some tax laws have survived only because they were intelligently administered, but the tax upon undistributed surplus, at least in respect to its application to operating corporations, has probably survived only because little attempt was made to enforce it. It has no doubt been recognized from the inception of the tax that the term "reasonable needs," when applied to so complex a structure as the average big business, is permissive of as many interpretations as there are interpreters. To define the term narrowly would spell the ultimate destruction of business.

In contrast with our system of taxing undistributed earnings, that of Great Britain gives evidence of an underlying policy of taxation far superior to ours. In England corporations pay a flat income tax rate of 22½ per cent. However, the corporation is permitted to deduct the tax, at the same rate, from dividend disbursements to its stockholders. The result is, in effect, that the corporation pays the tax only on its undistributed earnings.

It may be said that our corporate income tax rate is less than that in England. While this is true, we

Continued on Page Eight.

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Continued From Page One.

have in addition to the Federal tax State and local taxes with which Great Britain is not burdened. Moreover, the British system of calculating taxable income is more rational and equitable than ours.

May Carry Forward Losses.

In Great Britain the privilege of carrying forward losses, for example, enables a corporation to recoup shrinkage in capital, or other depletions resulting from trading losses, over as long a period as six years, before income currently earned is subjected to tax. Gains derived from capital transactions are not usually taxed in England, whereas we impose the tax on capital gains and, what is still worse, we limit the deductibility of net capital losses to the arbitrary amount of $2,000. If these comparative inequalities were translated into figures the result would undoubtedly show that the equivalent of rates paid by corporations under our system would greatly exceed the corporate tax under the British system.

Great Britain, with an experience of upward of a hundred years in the administration of income taxes, obviously realizes that in order to collect high rates of taxes without drying up the sources of income it is essential that the tax must so operate as to conserve and protect capital employed in business enterprise. Unquestionably the broad and equitable basic principles of application of the English income tax and the far-sightedness of those charged with its development have contributed in great measure to the economic and fiscal recovery of Great Britain.

While there is no reason to believe that the Treasury will deal harshly with corporations in applying this section of the revenue law, it would seem that there is more justification at this stage of business recovery for resolving any question of "reasonableness" in favor of the taxpayer than against him.

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