CHAPTER 8

Summary of Findings

It is necessary at this point, before summarizing the findings, to repeat the caution that in their derivation a number of particular assumptions were used. Resulting qualifications of the findings, set forth in detail (especially in Chapters 1, 2, and 4 and Appendix B), serve to warn the reader of reservations to be kept in mind in reviewing the following statements. The brief summary given here is intended only to underline the major points that emerge either as facts relevant to tax equity or as conclusions about the significance of the findings. Each must be interpreted with reference to the foregoing presentations of the underlying conceptual structure and the interrelations of factors affecting the income tax burden on stockholders. The findings, therefore, are more equivocal than their bald presentation here may suggest.

This brief review begins with a recapitulation of the answers, developed in the course of the study, to the two questions which marked its starting point: How heavy has been the extra tax burden on stockholders' pro rata share of net corporate earnings? How heavy has been the extra burden, measured in terms of effective rates on all of stockholders' income, compared with that for other taxpayers?

In arriving at an answer to the first question, net corporate earnings was broken down into two components—earnings for distribution and earnings for retention. *Earnings for distribution,* taxed at the corporate level when earned and the personal level when distributed, is the segment of net corporate earnings directly involved in the charge of double taxation. No surprise attaches to the finding that the earnings for distribution component was subject to heavier taxation in all years studied and at all income levels than it would have been if reached in full by the personal income tax alone. But there existed in every year consistent variations in the height of the extra tax load by income levels. For the differential against earnings for distribution (i.e., the net extra burden computed as a per cent of earnings for distribution) is an inverse function of the marginal rate of personal income tax to which a stockholder was liable. Therefore, in general, the higher the level of stockholder income, the lower the differential against earnings for distribution. At any given income level significant variations were found from year to year in the relative heaviness of the extra burden on earnings for distribution, variations determined by the gap between the corporate and personal rate which changed from year to year. For reference at various points in the summary, Table 41 gives the numerical results for 1950. (The reader is referred to Appendix A for summary data on the range of the value of the differentials over the period 1940 to 1952.)

TABLE 41

Differentials, 1950, Variant 2
(weighted average of joint and separate returns)

AVERAGE STOCKHOLDER IMPUTED GROSS INCOME (*$000's*)	DIFFERENTIAL AGAINST:			
	Earnings for distribution	*Earnings for retention*	*Net corporate earnings*	*Stockholder income*
1	34.3	30.0	31.7	5.7
3	34.3	29.1	31.1	6.5
5	33.8	28.8	30.7	6.0
10	32.9	26.0	28.6	9.9
15	32.1	22.0	25.9	9.7
25	29.2	15.2	20.6	9.5
50	24.9	0.4	10.0	5.9
100	19.1	—11.4	0.4	0.3
250	13.2	—26.9	—11.4	—8.7
500	10.0	—32.9	—16.3	—14.3

For the undistributed segment of net corporate earnings—*earnings for retention*—the results are more complex. At the lower stockholder income levels, earnings for retention were found to be overtaxed, while at the higher income levels they were shown to be undertaxed in comparison with the potential tax liability on this income segment had it been subject, in full, to the personal income tax alone[1] (except in 1940 when overtaxation prevailed at all income levels). The differential against earnings for retention, being a function of the potentially applicable rate of personal income tax, varied inversely with the size of stockholder income, and was positive or negative depending on whether the applicable personal rate fell short of or exceeded the corporate tax. Evidence on the degree of over- and undertaxation of this component of net corporate earnings for 1950 appears in Table 41, and for all years in Appendix A.

The degree of differential taxation of stockholders and the direction

[1] Low and high income levels are purely relative in this connection. The dividing line between them, which varied from year to year, occurred at a point in the income scale usually associated with the upper tail of the distribution. However, because stockholder income is more highly concentrated than the income of all taxpayers, the area of undertaxation was not limited to a minute segment of the distribution either in terms of number of stockholders involved or, more particularly, in terms of the fraction of earnings for retention falling in the undertaxed portion of the array.

of the differentials on the *net corporate earnings component* (i.e., whether it was overtaxed or undertaxed) depended on the stockholder income level. Net corporate earnings is the sum of earnings for distribution and earnings for retention, and the differential against it is a weighted average of the differential against each of its components. It was found, like the differentials on both components, to decline as stockholder income rose, in every year covered by the study. Moreover, in all but the first two years investigated (1940 and 1941) at some point on the income scale, the negative differential on earnings for retention outweighed the differential against earnings for distribution, causing a shift from over- to undertaxation of net corporate earnings. Thus it may be concluded that, while in all years of the decade of the forties and of the early fifties over most of the income scale the net corporate earnings component of stockholder income was overtaxed, in most years and for stockholders in the upper reaches of the income scale, undertaxation was the result.

These findings for the net corporate earnings component apply also to the *total of stockholder income from all sources*. But here the value of the differential is lower since the relationship is between the same absolute extra burden noted above and a base of income from all sources of which stockholders' pro rata share of net corporate earnings is only one component. In all years covered, over most of the income range, stockholders were subject to a significantly higher rate of income taxation than would have applied if all their income including their full pro rata share of net corporate earnings had been subject to the personal income tax alone. For stockholders near the top of the income array, however, the outcome was reversed; despite the corporation income tax, a lower tax liability actually occurred than would have been due on all their income including their pro rata share of net corporate earnings under the personal income tax alone. Unlike the other differentials which followed a smooth pattern of decline reading up the stockholder income scale, the pattern of the differential against stockholders starting from the lowest income level, rose to a peak typically around the $10,000 income level.[2] Then it declined continuously to a cross-over point after which it became negative and ran increasingly in favor of stockholders as their income rose. The results emphasize two problems raised in every year of the study except 1940 and 1941 by the existing method of taxing net corporate earnings: the overtaxation to which most stockholders were subject; and the undertaxation afforded stockholders at the upper income levels.

[2] This is explained by the varying proportion of corporate earnings to the total of stockholder income (see Chapter 2).

How are the results modified by alternative assumptions and definitions?

Under an assumption differing from that used in the standard method, e.g., the assumption that *part of the corporate tax is shifted* rather than that it all rests on corporate earnings, the results summarized above would follow the same general pattern with modification of the specific values of the differentials. The extra burden on corporate earnings (both segments) and stockholders would be lighter; the positive differentials at applicable income levels would be less onerous; the negative differentials at income levels above the cross-over would run more heavily in favor of earnings for retention, net corporate earnings, and stockholders. The cross-over from burden to benefit would occur lower down the stockholder income scale. The larger the proportion of corporate income tax assumed to be shifted, the more pronounced the difference between the results under the shifting assumption and the standard method.

Use of a definition of *corporate earnings as net of current costs of maintaining inventory and replacing depreciable assets* would lead to larger extra burdens compared with those summarized above for the standard method of this study, which accepts the Internal Revenue Service definition of corporate earnings as, in general, net of historical costs. In most years covered, especially those characterized by rising price levels, current cost adjustments for inventory and depreciation would result in higher differentials against corporate earnings and stockholders, lower differentials in their favor, and the occurrence of cross-over points higher up the income scale.

If the *shifting assumption and the current costs adjustment* were combined and differentials computed on this basis, the general pattern resulting would, on net balance, be the same as the standard method's, but undertaxation would appear further up the income scale, and the degree of overtaxation would be heavier.

Consideration of *only corporate earnings for distribution* in analyzing the differential burden on stockholders led to differentials against net corporate earnings and stockholders lower at all income levels than those obtained by the standard procedures in which retained as well as distributed earnings were imputed to stockholders. The differentials against stockholders in the lower brackets were shown to be lower, and in the higher brackets to be higher. No cross-over occurred in this test from extra tax burden to tax benefit at any level of stockholders income.

How would federal revenue be affected by the abolition of differential taxation of stockholders?

All differential taxation of stockholders would be removed if the corporate tax were abolished and their tax liability were computed by the same method that now applies to partnerships, i.e., by taxing their full pro rata share of corporate earnings fully and promptly as part of personal income. Without judging the desirability or practicability of this method, estimates were made of the effects of such a change on the federal government's revenue. (The difference in revenue yield may also be construed as the net revenue contribution of the separate and distinct corporate levy as compared with the alternative possibility of taxing corporate earnings fully and promptly under the personal income tax.) By a related set of computations the aggregate extra burden on stockholders was measured.

Detailed estimates were made for 1947, 1949, 1950, and 1952. For 1947, it was found that, given the assumption that the corporate income tax is not shifted, abolition of this tax coupled with the prompt and full taxation of stockholders' pro rata share of net corporate earnings would have resulted in no immediate loss of revenue to the Treasury. If anything, there might have been a slight revenue gain in that year. However, because the basis of valuation of stock for computing capital gains in the future would have been raised by the amount of imputed undistributed earnings, capital gains tax collections in the future would have fallen one billion or so short of what they otherwise would have been. For 1949, the total revenue loss was found to be heavier. Current revenues would have been lower by about $2 billion, with an additional $1 billion revenue shortfall showing up in later years. For 1950 the estimated current decline in revenues would have been on the order of $3 billion plus a future revenue loss from a lower capital gains tax liability of about $1.5 billion. For 1952 a heavier current revenue loss was estimated, $5.7 billion, plus a future revenue loss of $1 billion. Of greatest contemporary interest is the finding for 1955. (The estimate in this case is less accurate than for the four years just mentioned.) In 1955 itself the change in the tax treatment of corporate earnings called for by the partnership method would have cost the Treasury some $5 billion, with an additional billion and a quarter of revenue loss via lowered capital gains tax liability showing up later. To recoup the immediate revenue loss, a rise would have been required in personal income tax rates of about 3.3 percentage points applied to all taxpayers. An analysis limited to taxable stockholders (those who were reached by the personal income tax) resulted in a somewhat different picture. In 1950, for example, their current tax liability would have been only about $600 million lower under the partnership method. Under this aggregate, however, lay great diversity in income class experience; the partnership method would have yielded a lower tax liability, in the aggregate, for stockholders in the imputed gross income classes up to $100,000 and a higher tax liability in the classes over this level.

Does the corporation income tax increase or decrease the progressivity of the income tax structure?

Investigation of the effect of the corporation income tax on the progressivity of the income tax structure was necessarily restricted to stockholders since, under the standard assumption, they are the only personal income taxpayers affected by the corporation income tax. Extreme examples found of differential rates of income tax on stockholders with the same taxable imputed income led to the conclusion that, at best, the progressivity effect is very crude because it affects only stockholders, and it affects unevenly stockholders with similar total incomes. A further examination restricted to average stockholders in which this unevenness was averaged out, showed the progressivity effect to be different under each of two definitions. Under one, the effect was only partial, greater progressivity over the lower and, in some years, the middle span of incomes, with the rest of the income range less progressively taxed than it would have been under the personal income tax alone. Under the other, there was virtually no progressivity effect; on the contrary, in almost all cases stockholders were taxed less progressively than they would have been without the corporate tax and with their corporate earnings subject in full to the personal tax.

How do the relief provisions of 1954 affect the income tax burden of stockholders?

Finally, the stockholder relief provisions of the Internal Revenue Code of 1954 were investigated. The two applicable features of the revised code are the exclusion of the first $50 ($100 for joint returns) of dividend receipts from taxable income, and a credit against personal income tax equal to 4 per cent of dividends over the excluded amount. These provisions were examined first within the context of their avowed purpose, to alleviate to some extent the double-taxation of dividends. They were found subject to criticism on the grounds that they take account only incidentally of the fact that, because personal income tax rates are progressive, the weight of double-taxation declines as stockholder income rises. The relief behaves capriciously. Detailed analysis at selected average stockholder income levels showed the greatest degree of relief at the bottom and top of the income scale. In perspective against the background of retained as well as distributed earnings, the relief provisions moderated overtaxation only slightly (and after a point inversely to the rate of overtaxation) while undertaxation was made more pronounced.