

## PROBLEMS OF CORPORATE TAXATION IN TIME OF WAR

ROY BLOUGH\*

Five revenue acts in three years have transformed the federal taxation of corporate profits from an income tax taking approximately 17% of the \$7.2 billion income of profitable corporations in 1939 to a combined income tax and excess profits tax which took approximately 56% of a \$20.8 billion income of such corporations in 1942. It is expected to take 57% of an income of \$23.4 billion in 1943. In the fiscal year 1940, corporation income and excess profits taxes constituted 21% of total Internal Revenue collections. In the fiscal year 1944, assuming continuation of present tax laws, corporation income and profits taxes are expected to yield about 35% of total Internal Revenue collections.<sup>1</sup>

These striking changes in the amount of corporation taxation might have been achieved by simple rate increases acting on a rapidly rising volume of corporate income. Actually, however, higher rates have been accompanied, and indeed overshadowed, by major changes in the methods of taxing corporations. A wartime system of taxing corporations, not merely a peacetime prewar system with higher rates, has been devised and placed in operation.

The changes in corporate tax structure were made because a satisfactory policy of taxing corporations in time of war involves not merely meeting the need for increased revenue, but also facing many other problems as well. Some of these problems were carried over from the prewar years, others have arisen primarily because of war, and still others relate to the period of postwar readjustment.

Tax problems are presented to Congress in very practical form. Congressional tax committees are denied the intellectual pleasure of theoretical study, of concentrating on some single objective, such as the equity of taxes, with no responsibility for, or necessary interest in, results of other kinds. Congress and its committees must act—and act with due regard for all the consequences. Their action takes the homely forms of specifying precisely what is to be taxed, at what rates the tax is to be imposed, and how and when it is to be collected. To do this they must balance

\* Ph.D., 1929, University of Wisconsin. Director of Tax Research, United States Treasury Department, since 1938. Chief Statistician, Wisconsin Tax Commission, 1927-1932; Associate Professor of Economics, Graduate School of Public Administration, University of Cincinnati, 1932-1938. Author and joint author of various articles and works in the field of taxation.

<sup>1</sup> The tax figures are gross amounts. Post-war credits and the carrybacks of losses and unused excess-profits credits will reduce the final tax burdens substantially below these levels.

competing considerations and compromise conflicting interests; they must decide what results they desire to accomplish; they must achieve those results through altering an intricate legal and administrative machine that impinges on a complex economic organization. Congress must do its work in an atmosphere in which almost every taxpayer has a special interest to promote and in which a great many irrelevant issues must be examined and eliminated.

Acceptance of the winning of the war as the primary objective of tax policy is of some value in facing wartime tax problems, but by no means assures their solution. Many things are necessary to win the war and frequently they are alternatives—the more of one, the less of the other. Both ends of a seesaw cannot be up at the same time. It takes a fine sense of balance to get the most benefit from scarce resources. This balancing is notably difficult in war finance. To take two examples: Heavy taxation digs into tender flesh, economically speaking; light taxation leaves the door open to disrupting inflation. Again, high excess profits taxes may drain the vigor and efficiency of business enterprise; low excess profits taxes may lower the effort and morale of industrial workers, farmers and soldiers. What is the optimum point?

The changes under consideration here date from 1940. The 1940 and 1941 Acts were passed during the prewar period of "defense." The country had just emerged, perhaps was still emerging, from a long period of depression. The intellectual and emotional stigmata of the depression years were still evident. The climate of opinion changed substantially from 1940 to 1942 and 1943; the emphasis among different problems and aspects of problems shifted. For purposes of convenience, however, the whole period may be referred to as the "war period," except where greater precision appears necessary.

#### PROBLEMS CARRIED OVER FROM THE PREWAR PERIOD

Among the difficulties that Congress faced in constructing a corporate tax structure for the war were some of long standing which were underscored by the war. Of these chronic problems, two of the most puzzling are the measurement of business profits and the determination of the proper place of the corporate entity in taxation.

##### *The measurement of business income*

The taxation of any kind of business income, whether corporate, partnership, or proprietorship, presents perplexing questions. The statement of the amount of income or loss experienced by a business organization during any year must at best be an approximation; at worst it may bear no discernible relation to the facts as they are ultimately revealed. Business is a continuing process; to measure the income for the short segment of one year requires placing values on such things as buildings, equipment and inventories from which income is expected to flow in the future. The present value that is placed on expected future income reflects "the ectoplasm of a hope, not the solid granite of a fact."

This dignified guessing of the future is more difficult for long-range projects and projects in which capital rather than personal service is relatively the most important factor. These types of business ordinarily employ the corporate form.

Taxation of business income is difficult also because every variety of business has its own peculiarities of income determination. Measuring the annual incomes of a mine, a factory, a sales organization, a cattle ranch, and a motion picture studio involve widely differing complications. While some of these differences can be recognized in the tax law, the application of uniform rules to all kinds of business corporations is necessary for practicable administration. This very uniformity makes inaccuracy unavoidable.

Long-run accuracy in measurement of business income is assisted by allowances such as those for depreciation, depletion, and loss on retirement of machinery. Errors in allocating such allowances among years affect the amounts of taxes paid if losses occur in some years or if tax rates change. Prior to 1940 the principal statutory provision which made possible some adjustment for errors in calculation of the income of any year was the two-year loss carry-forward provision, which was restored to the law in 1939. This loss carry-forward provision did not, of course, apply only to those cases where a loss was due to the erroneous allocation of an item of income or loss in a given year or the erroneous valuation of an asset as of the beginning or end of the year. It also served to equalize somewhat the tax between corporations with violently fluctuating incomes and corporations with relatively stable incomes.

#### *Tax problems inherent in the corporate form*

A second difficult peacetime problem carried into the war period was the proper method of taxing corporations. Corporations are relatively easy to tax. They are all registered with state governments and cannot readily escape scrutiny. The great bulk of income and assets are in the hands of relatively few corporations; this means that auditing is facilitated.

Nevertheless, the business corporation presents perplexing questions of tax policy because of its characteristics as a form of business organization. The corporation is not simply a body of people who have joined themselves together to accomplish some common end. A large business corporation goes far beyond such simple cooperative group action. On the other hand, the corporation is not a completely independent entity, a sort of group person existing and functioning without regard to the natural persons who comprise it. The problem is to devise a method of taxation which will recognize the dual character of the corporation. A suitable technique might not be difficult to devise and apply if the relationships between the stockholders and the corporation were uniform throughout the corporate field. Actually, however, the relations of the stockholders to each other and to the corporations are of infinite variety, ranging from the close personal intimacy of the incorporated person or partnership to the impersonal relations of a large public corporation where no one stockholder owns more than a small minority of the voting

shares. There are large corporations and small corporations; growing corporations, stable corporations, and declining corporations; corporations with stocks closely held and corporations with stocks widely distributed; regulated corporations and unregulated corporations; corporations financed with bond issues, corporations with preferred stock issues, and corporations with neither; holding corporations and operating corporations; over-capitalized corporations and under-capitalized corporations; corporations with accumulated deficits and corporations with earned surpluses; corporations with harmonious stockholders and corporations with antagonistic minority interests; corporations run by management, corporations run by bankers, corporations run by a few large stockholders, corporations run by the mass of stockholders, and corporations that do not seem to be run by anyone. It is no wonder that a generally satisfactory method of taxing business corporations, either in peace or in war, remains yet to be imagined, let alone to be devised and adopted.

Although for constitutional reasons, the income tax on corporations<sup>2</sup> preceded the income tax on individuals, the corporation tax in the early years after 1913 may be considered in effect an adjunct to the individual tax. The original corporation tax rate of 1% was the same as the normal tax rate on individual income and dividends received by stockholders were not subject to the normal tax on individuals. Thus, with respect to the normal tax the corporation tax was analogous to collection at source. Dividends paid out of corporate capital funds or out of earnings before March 1, 1913 were not subject to normal tax or surtax in the hands of the receiving stockholders.

The first divergence between corporate and individual normal rates was in 1917, when the individual normal tax was imposed at two rates, and the corporation rate was made equal to the higher of the two, and an excess profits tax was imposed. The divergence continued after World War I. Beginning in 1919 the corporation income tax rate was lowered to 10%, but the maximum normal tax rate on individual income was still further reduced to 8%. The margin thus introduced between these two tax rates was widened when the 1921 Act raised the corporation rate to 12½% for 1922, to replace the revenue loss through the repeal of the excess profits tax. By 1929 the maximum normal tax rate on individual incomes had been reduced to 4%, while the corporation tax rate, at 11%, was nearly three times as high.

The corporation income tax could thus no longer be regarded merely as an advance or source collection of the normal individual income taxes.<sup>3</sup> On the other hand, the tax was still not a completely impersonal tax, since individuals were free from the normal tax on income from dividends. Congress presented no new principles of taxation in justification of the change in policy. Such explanations as were made usually ran in terms of the need for revenue.

<sup>2</sup> While to avoid constitutional obstacles, the federal corporation tax of 1909 was legally a franchise tax, it was measured by net income. *Flint v. Stone Tracy Company*, 220 U. S. 107 (1911).

<sup>3</sup> It was never precisely this, since the individual surtax did not apply, as it does in Great Britain, to dividends plus corporate tax.

In 1936 an attempt was made to integrate the corporation income tax with the individual income tax. The House of Representatives, following the recommendation of the President, passed a bill repealing the income tax on corporations and replacing it by a tax on undistributed profits. Under this bill distributed income would have been taxed only in the hands of individuals, while corporations would have been taxed only on undistributed income. However, the Senate was unwilling to accept without qualification this new approach to corporate tax problems. An undistributed profits tax was finally adopted. But the corporation income tax was retained and the rate graduated for corporate incomes of less than \$40,000. In addition, individuals were no longer permitted to exclude dividends from income for normal tax purposes.

This compromise, which was incorporated in the 1936 Act, accentuated still further the issue of personal or impersonal taxation of corporation income. While the undistributed profits tax was an impersonal tax, its purpose and tendency was to bring income earned by corporations into the orbit of personal taxation; thus the corporation tax served as a supplement to the tax on individual income. But the denial of the dividend deduction to individuals was a move in the direction of impersonal taxation. The undistributed profits tax was vigorously criticized. In 1938 the rates were sharply cut and a date of expiration was set, and in 1939 the tax was allowed to lapse as of the end of the year. Only minor ties remained between corporation and individual taxes. They included an old penalty tax on income that is withheld from distribution in order to avoid individual income tax, a new (1937) tax on undistributed earnings of personal holding companies, and a provision (1939) for exemption from corporate tax of certain investment companies except with respect to undistributed income.

#### *Aggravation of problems by the war*

With the approach and outbreak of the war the difficulties involved in taxing corporations became more serious. The unsettled conditions brought about by the war, the conversion of plants and facilities to wartime production, the expectation that reconversion would one day be necessary, rapid changes in prices and costs, more difficult measurements of depreciation and obsolescence, the greater uncertainty of markets—all these factors combined to increase the difficulty of computing corporate profits in any year. There was even the question of accurately computing corporate profits for the war period as a whole. Apparently large wartime profits might be offset by the loss of capital value due to a shift of markets, the entry of competitors or the discovery of new technique and equipment. What appeared to be a profit in one year or even for the whole war period might turn out to be a loss, and what appeared to be a large profit might turn out to be a small one.

Not only were the dangers of making errors in the computation of income greater during the war than in the preceding time of peace but these errors became of increasing importance. If the rates of tax are low, errors in the calculation of profits from year to year are of relatively small significance. At a 10% rate of tax

it is rarely a matter of serious concern for the capital position of the corporation whether or not its profits are correctly computed. Even if twice as much profit is taxed as is actually realized the corporation still has 80% of its profits left to pay dividends and build up its capital. High tax rates, however, make a free and easy attitude toward the accuracy of profit computation a serious matter. If an excess-profits tax of 80% or 90% is imposed, and if by some mistake in calculation or in definition the profits are figured at twice their actual level, the tax may take not 80% or 90% of the profits but 160% or 180%. If such errors should continue over a period of time the business would go bankrupt. In any event there would be an actual loss after taxes instead of a profit.

Accordingly an important objective of wartime tax policy was to improve the calculation of profits or to make possible the hindsight adjustment in profits so that only actual profits would be subject to tax.

High rates of corporate tax also aggravated the discrimination against the corporation as a method of earning income to the extent that income was distributed in dividends. Low rates of tax on corporate profits would have discriminated in favor of the corporation to the extent that income was not distributed in dividends during the period of high war income tax rates. High corporate rates were particularly appropriate for those concerns whose incomes increased during the war since such increases were undoubtedly in general due to the war and the Government's war expenditures. For concerns whose profits had not increased, however, higher rates of taxation meant that the discrimination caused by the fact that the corporation was an intermediary between the individual stockholders and the source of income became more serious.

#### PROBLEMS ARISING PRIMARILY OUT OF THE WAR

Added to the peacetime problems of corporate taxation, accentuated in time of war, were other problems attributable largely or solely to the war. The Government's revenue requirements were so much increased by the war as to constitute a difficulty almost of different kind instead of merely one of different degree. Profits growing out of war production presented a point of controversy. The overwhelming importance of unimpeded wartime production had to be reckoned with. Inflation threatened after a long stretch of years during which deflation had been the condition to be remedied.

There were other problems raised by the war which would be met after the war. These were truly wartime issues because they cast their shadows before them and affected the activities of both businessmen and Government in the consideration of war taxes. Another class of postwar questions may be anticipated during the war and provision made to go into effect after the war, but these are not truly wartime problems if nothing need actually be done during the war.

The distinction between a war tax problem and a wartime postwar problem may appear to be tenuous. Both arise out of the war; both call for consideration

during the war. The difference would appear to be this; if it affects production during the war, it is a war problem, but if it affects the postwar situation of industry, it is a postwar problem. An illustration may make this distinction clearer. The amortization legislation of 1940 was not intended primarily to protect industry in the postwar period and insure its equitable treatment then. The purpose of the legislation was to get on with war production which was allegedly being delayed by the unwillingness of business to make investments in wartime plants and equipment because of the uncertainty of getting back the investment. On the other hand, proposals for tax deductions for postwar reconversion reserves have been put forward, not so much to increase wartime production as to insure the existence after the war of the type of industrial machine and business control which is deemed desirable for that period, and to provide a correction for one source of error in statements of wartime profits.

The problems affecting conduct during war will be discussed in this section; the postwar problems seen growing out of the war and thereby affecting the war tax program will be discussed in the following section.

#### *Additional revenue requirements*

New revenue is an obvious wartime tax problem. As defense expenditures accelerated and then became war expenditures running up to unheard of levels, the need for greater revenue correspondingly expanded. Although some students of taxation are opposed to levying more than a nominal rate of tax on corporations, this view was not shared by the Congress. Members have pointed out from time to time that their constituents would not understand why the taxes on individuals should be increased unless the taxes on corporations were increased by at least a corresponding amount. Moreover, the ease of taxing corporate profits perhaps made inevitable the raising of a substantial portion of the newly raised revenue from the business corporations of the country. Finally, the strong influence of the high individual rates and other factors to discourage dividend payments during the war made higher corporate rates a necessity for tax equity, despite a resulting element of inequity.

#### *Prevention and recapture of excessive profits*

Although the need of revenue was responsible for substantial increases in corporation taxes during the war, the high corporation excess profits tax rates were not primarily the result of the need for revenue. The increased revenue could have been derived more simply and with less expenditure of time and energy by the Congress through higher income tax rates than by imposing the excess profits tax at such high rates that all sorts of relief provisions were required to prevent the heavy tax from causing hardships.

The primary reason for the excess profits tax was the public pressure for the limitation of wartime profits. Such pressure was not restricted to the United States. Both Great Britain and Canada imposed excess profits taxes early in the war at

very high rates. It was felt, at least in the democratic countries, that no one should make an inordinate profit out of a war in which conscripted men were risking their lives and in which many small businesses were being destroyed. There were wide differences as to what constituted unreasonable profits. Although unreasonable profits were obviously profits in excess of reasonable profits, the word "reasonable" added nothing to definiteness. Reasonable profits were interpreted by different people to mean everything from a sort of guarantee of peacetime profits after all taxes plus a generous percentage from the additional wartime business, down to almost no profits at all. But there was no difference of opinion on the point that, above some level, profits were undesirable in time of war and that insofar as practicable such excess profits should be completely wiped out.

This public attitude involved more than a matter of equity. It directly affected the production of goods necessary to the prosecution of the war, and the maintenance of stable economic conditions. The point was clear that income stabilization was needed. A policy of wage control developed; workers were expected to put forth their maximum efforts with stabilized wages and salaries. Price control likewise evolved; it was highly desirable that farmers raise maximum crops with stabilized farm prices. The cooperation in the war effort which could be expected of these groups whose incomes were limited would depend at least in part on what they saw happening to the incomes of other people who were not subject to the same types of restriction. These other incomes were primarily in the form of business profits—the profits of people who were employers of labor, some of whom were processors of farm products. The excess profits tax was the instrument adopted to restrict the incomes of this group. The success of the tax in securing the full cooperation of labor and farm groups would be one of the tests of its adequacy.

An important problem in the excess profits tax was the measurement of excessiveness and around this question was waged a vigorous fight. One view was that wartime profits were unreasonable when they were unusually high as compared to invested capital, regardless of how high they had been before the war. The other view was that profits were excessive when they were larger than before the war. The revenue acts of the First World War had incorporated taxes based on both of these tests of excessiveness. Whether or not both tests should be employed in the present war became an important issue.

There was no lack of discussion of war taxation in the decade prior to the war and almost all of it was devoted to the problem of preventing or recapturing excess profits in wartime. During the years between 1930 and 1940, numerous war finance bills and resolutions were discussed in both Houses of Congress. Some of them dealt with such questions as price fixing and profit limitation, or restriction. A large number of them were concerned with wartime taxation, and centered mainly around recommendations of the War Policy Commission<sup>4</sup> made in 1932, and rec-

<sup>4</sup> H. R. Doc. No. 264, 72d Cong., 1st Sess. (1932).



ommendations of the Special Committee on the Investigation of the Munitions Industry<sup>5</sup> made in 1935. The former proposed a flat rate tax of 95% on profits in excess of the average of the three preceding years. The latter committee recommended that profits in excess of 6% of the invested capital be taxed at a 100% rate. The discussion of excess profits taxation was thus important in Congress long before the excess profits tax was passed in 1940.

A profit recapture plan was placed in operation as early as 1934 with the passage of the Vinson-Trammel Act. This act provided for the recapture of all profits in excess of 10% of the contract price realized in the construction of naval vessels and aircraft. This type of provision was modified and extended in the years prior to the war.

#### *Promotion of war production*

Opposed to the considerations favoring heavy excess profits taxation were other considerations which raised a warning hand against rates so high as to weaken enterprise and destroy the incentive to efficiency. It may be doubted that the profit motive as such is of great importance in wartime. Few patriotic Americans would refuse to do their utmost in war endeavor, regardless of the size of profits. But it is not merely a matter of the size of profits; the question is also one of the loss of capital.

Although the Federal Government took many of the risks out of wartime business through its policy of furnishing capital, either in the form of facilities or in the form of loans, there was still a good deal of risk placed on private industry. The very size of the business in relation to the amount of private capital increased the risk of the loss of that capital through misjudgment or inadvertence. There was also a good deal of work and responsibility; and while this was no doubt offset to a considerable extent by the pleasures of management and the feeling of contribution to the war effort, there was nevertheless a general feeling that business profits must be not only reasonably low, but also reasonably high—high enough to reflect a reasonable return for the risk run and the managerial effort expended. Unfortunately, the ideas of what the entrepreneurial and managerial groups considered a reasonably high return, and what labor and farm groups and the public generally considered a reasonably low return, were not necessarily identical.

More definitely related to profit margins than is incentive to wartime effort is the incentive to efficiency of operation. Even in the absence of net profits after taxes, business managers and stockholders have an incentive to keep down costs during the war, since should the cost structure become inflated and distorted, the ability of the concern to compete in the postwar period would be impaired. This incentive is greatly strengthened by the provision for carry-back of losses and unused excess-profits credit, which provision makes even the profits that go to the Government in taxes valuable for purposes of future carry-back. However, there are offsetting

<sup>5</sup> SEN. REP. NO. 944, Pt. II, 74th Cong., 1st Sess. (1935).

forces. High excess profits taxes, by reducing the net return on each dollar of output, make high costs less important. If paying higher wages will assure production and especially if those higher wages will be paid for by the Government in its higher contract prices, the tendency is strong to make the payments to labor and secure its good will during the war and perhaps for the postwar period. If advertising can be expected to yield results even at some future period, cost is a relatively minor factor if 80% is being paid by the Government through lower excess profits taxes. With regard to these and other elements of cost, high taxes on profits undoubtedly reduce the incentive to maintain business efficiency.

Various devices grew out of the effort to resolve the conflict between considerations for and considerations against a high excess-profits tax. Carry-forward and carry-back of unused excess-profits credit, the adjustment of the credit through "general relief," and the postwar credit were among these devices.

A special problem of promoting war production, which became acute in 1940, concerned the treatment for tax purposes of new plants and facilities constructed for the production of war goods. Manufacturers were reluctant to undertake these specialized capital investments without assurance that the loss of value during the war could be deducted from wartime profits. The problem involved a special application of deductions for depreciation and obsolescence. If wartime facilities were useless and worthless after the war, how was the manufacturer to get back his investment? The law provided then, as now, that depreciation might be taken as a deduction, as could obsolescence. Depreciation is based on physical life which might extend far beyond the end of the war. Obsolescence relates to economic loss of value, but is a difficult concept to apply administratively. It is hard to recognize obsolescence while it is occurring. It is sometimes difficult to determine that it has occurred and even more difficult to put a date on the occurrence. Obsolescence resembles loss in capital value due to shifts in demand, cyclically low production, and other more purely market factors in periods of business decline. Failure to distinguish obsolescence from these other factors would be of little significance to a correct statement of profits in the absence of business recovery. But business recovery causes capital appreciation in situations where obsolescence was not the cause of the earlier value decline. Truly obsolete equipment does not ordinarily appreciate when markets recover, since such equipment will have been replaced by technically superior and newer equipment. If all declines in capital are to be allowed as deductions from income then the restorations in capital value reflecting the restoration of markets should be counted as income. But taxing as income such accrued capital values not only outrages accounting traditions as to the nature of income, it also magnifies fluctuations of income and taxes and may lead to collecting taxes without regard to the business done and the profitability of operations.

Just how important were the uncertainties of charging depreciation and obsolescence against the income of the proper year is impossible to say. If the new plants were of such a character that they could continue to be useful after the war,

the amount of depreciation allowed under the Internal Revenue laws would be adequate as an income tax deduction. On the other hand, if the assets proved of little or no use after the war, either because the products would be useless in peacetime or because of an overabundance of such facilities in the postwar period or because of war inspired technological improvement, the usual deduction for depreciation would be inadequate to return the investment and reflect the true income earned during the war. The amount of difference this would make in taxes would depend on the rates of the tax and the income or loss position of the corporation in the postwar years. At any rate, businessmen insisted on special legislation to assure them that they would be able to take the cost of their wartime facilities as deductions during the war.

No exact solution was conceivable except a promise to recompute profits after the war, and promises were not definite enough. Measures that were definite were bound to result in inequities. Allowing deduction during the war of the full cost of the assets would understate the war profits of some concerns and thus undertax them. Failure to allow especially rapid deduction would, on the other hand, result in the overtaxing of other corporations. Advance determination of which situation would prevail could not be made for specific cases. Special amortization legislation was certain in any event to fall short of a fully satisfactory solution.

#### *Control of inflation*

Another important objective of war taxation is to contribute in maximum degree to the prevention and control of inflation. Because wartime inflation is due to an excess of spending power in a period of shortages of goods and services, the withdrawal of income through taxation is generally recognized to be an important instrument of inflation control. The circumstances which made the need for inflation control obvious in the latter half of 1943, were, however, not apparent in any great degree in the summer of 1940 when corporate tax revision for the war period was first undertaken. At that time the country was gradually emerging from a period of unemployment, low prices, and stagnant business. There was a substantial amount of room for growth in the output of the business machine without pressing on the capacity for production. Accordingly, the possible inflationary influence on prices of the increased governmental expenditures for defense purposes did not appear to be an important factor.

Even when productive capacity was approached and the strain of excess spending power on price controls became all too clear, the function of taxation as an instrument of inflation control was not given the acceptance or at any rate the emphasis which it received in some quarters. Several explanatory factors may be suggested. There are many problems on the minds of members of Congress, and little time for the complications of fiscal theory. The emphasis on price control and rationing indicates a preference for those methods of preventing inflation. Again, the legislator is close to the people back home. He sees each of them as a human being trying to improve his economic situation. Very few people are aware

that they are contributing to inflation. If their income rises, they feel that at long last they are receiving more nearly the reward which their labors had long since entitled them to. The cost of living, to be sure, threatens this newly found prosperity and security, but taxes would threaten them also. The average person apparently does not see increases in taxes as holding any benefit for him; rather he sees taxes as a reduction in his ability to buy, thus striking at the possibility of his reaping his overdue reward.

Even to the believer in taxation as a fundamental method of preventing and controlling inflation, the corporation does not appear as close to the inflationary picture as the individual. When corporations expand their facilities they spend money and thus contribute to the demand for goods and services on the market. But in the summer of 1940 there were few actual or threatened shortages of a character to give cause for immediate alarm. In 1941 and especially in 1942 and 1943 when shortages began to arise and finally became very critical, the system of priorities and the very existence of the shortages themselves reduced the ability of corporations to expand facilities for other than essential war purposes and indeed frequently prevented them from replacing deteriorating equipment or depleted inventories. Accordingly, money in the hands of corporations did not directly contribute in a large degree to the pressure on prices.

Of course, when corporations pay out their earnings in the form of dividends the pressure on prices is increased because of the larger incomes in the hands of the consuming public. Wartime dividend policies have been in general conservative because of high corporate and individual taxes, the costs of conversion to war production, the requirements of expanding war production, and the felt need for accumulating reserves and perhaps for other reasons.

In brief, the control of inflation was probably of little moment in 1940 and apparently had little, if any, influence on the revenue legislation of that year. In 1941 and 1942 the control of inflation had become of more importance for tax policy generally, but it was probably not an important factor in determining the increasingly high corporate tax rates.

#### WARTIME POSTWAR PROBLEMS

As the war progressed, more and more attention was given to the problems of the postwar period. What were businesses to do when the flow of war orders had ceased and the necessity to reconvert and readjust the plants and equipment to peacetime use became an immediate necessity? Wartime tax policy could not remove the problem. The best it could do would be to leave businesses in as favorable a position as possible to continue after the war consistent with a minimum of conflict with the wartime objectives of taxation.

Part of the trouble went back to the difficulty of measuring profits, especially in time of war. If, after the war was over, part of the wartime profits were found to have been apparent but not real, taxation might have impaired the capital of the company and left it worse off than it was before the war so far as capital was con-

cerned. This undesirable result was avoided to a considerable extent by providing a loss carry-back of two years. The loss carry-back method had the disadvantage that it made no distinction between wartime losses tied up so closely with wartime profits as to constitute a genuine adjustment of such profits, and ordinary business losses of the postwar competitive struggle.

The cost of postwar reconversion became a particular item of interest during the early part of 1943. It was felt by some observers that the loss carry-back provision was inadequate and that something additional should be allowed to free from taxation such amount of wartime income as would be used up in reconversion to peacetime operation. But the problem was peculiarly puzzling. During the war it was scarcely feasible to determine which companies would have to reconvert, or the probable costs of reconversion. Many corporations would never go back to their prewar line of business. Moreover, at the time of adjustment to peacetime conditions it was certain to prove difficult to ascertain which outlays should be chargeable as expense of reconversion, and which should be considered normal capital expansion to meet a new business situation.

The concern with the postwar conditions in which corporations would find themselves extended beyond the correction of wartime income to the cash position of the corporation. The cash problem is not at all the same problem as the problem of correctly figuring costs. A corporation with large assets and ample profits may be in a very illiquid position while another corporation may be very liquid and yet have made no profits. Although open or concealed rate reductions would affect the amount of cash a corporation would have at the end of the war, the problem of the cash position is largely in the field of business management and its relief is perhaps to be found in the banking and credit field. For concerns with war contracts, the policy of contract termination is also important for the postwar cash position.

There are other postwar problems, such as the future competitive situation among firms and industries, which are also sometimes presented as part of the wartime tax picture, but for the most part these seem rather far removed from the area in which wartime tax policy can be a helpful instrument.

The problems which Congress had faced during the past few years in determining wartime corporate tax policy are seen from this examination to be complex and confusing and full of conflicting considerations. No policy could have satisfied in full all the tests of good war finance. It has been necessary to balance considerations, to choose among conflicting interests. As the war passes into history it will appear more clearly whether the balancing has been intelligent and the choices best for the general welfare. But for Congress the end of the war will bring no rest from concern with corporate taxation matters. The wartime structure is obviously not suited to the postwar area; then the peacetime problems of corporate taxation will call for solutions adapted to new times and new conditions.