

CHAPTER XIX

Taxing "Utilities" and Other Corporations

THE FOLLY OF TAXING "PUBLIC SERVICE" AND THE INEQUITY OF CORPORATION TAXATION GENERALLY.

I have warned the country against unwise governmental interference with business; I have pointed out that the policies of the present leadership . . . in the last few years have constituted dangerous back-seat driving . . . I am opposed to their kind of governmental interference with business. It means casual, dangerous tampering.

—FRANKLIN D. ROOSEVELT
before he became president

THE taxation of corporations presents peculiar and serious difficulties. Practically, in many businesses, taxes absorb so large a part of earnings that everyone suffers—employees from reduced wages, customers in high prices, investors in diminished returns on capital, and all society through the hampering of industry. While this is generally true of all business, it is perhaps most obvious in the case of the "utilities"—those companies which provide a universal service recognized as essential to practically all the people—transportation, gas, electricity, communications, and the like.

The problem is essentially simple and amounts to this: the consumer cannot and will not pay enough to cover (1) crushing taxes, (2) adequate wages to employees, and (3) returns to stockholders which will attract and justify investment, or even continued operation of many a business.

In the case of local transit, subways, and in many bus operations throughout the country, taxes take so much that not enough is left to yield a fair return to owners and to pay fair wages. The consumer is paying all he can and all he will pay. In the case of bus and subway fares, increase often does not bring added revenue because business falls off to more than offset the higher charges. Raising prices may wreck communities or kill industries: the situation on the Long Island Railroad is a case in point. It is doubtful if many of the workers can afford to pay higher commutation fares; and if they cannot, the service must suffer, as it has; employees will be underpaid, as they sometimes are; and the road will be virtually bankrupt, as it is.

The problem reduced to lowest terms becomes elementary

arithmetic, like that of many a householder working out a family budget. Rent takes thirty percent, food twenty percent, clothing twenty percent, medical and miscellaneous twenty percent, and taxes twenty-five percent—a total of a hundred and fifteen percent of income! As long as two and two make four, there is just one way to settle it and that is to cut out something. Just so with the corporation. Raw materials go up and cannot be controlled; labor costs are higher than ever; taxes have soared sky high! It may become impossible to attract investment or to stay in business. To cut wages means strikes and a lower standard of living, which the workers will not tolerate. The only recourse is to cut corporation taxes.

It would be most desirable to free all public service companies from all taxes. There is valid reason for regulating their rates, supposedly fixed at a point fair to the public, to workers and to stockholders, although the latter are not always considered. Assuming that this is the principle underlying rate-control legislation, any material reduction in expenses should be reflected in lower rates, and these services are used by everyone directly or indirectly. The return to owners would be kept on a reasonable basis, and there would be no opportunity for "profiteering." The imposition of any tax increases the cost of these essential services, light, heat, power, telephone service, and travel. As a matter of fact, the charges, if apparently extortionate, are generally so only because of the tax which must be paid. Users suffer, not from extortion by the company, but from extortion by the government.

Frequently there is both misunderstanding and misrepresentation. In one state there was much agitation for publicly owned electric generating plants. The argument was put forward that they would not have to pay any taxes, so service would be cheaper! This is too transparent to delude any intelligent man: it simply means that the government is collecting taxes on charges for the services rendered; and, if the companies were freed from taxation, rates would be much lower and the deficit would have to be covered by other taxes. The same reduction in rates could be effected by simply untaxing these corporations; and, doing this, we should escape the drawbacks of political control, always associated with waste and inefficiency and frequently with graft and corruption.

It would be well if corporations would do more to bring it home to stockholders, employees, and especially to customers, that a large part of the price, supposedly paid for their services, is actually paid for taxes. We often hear complaints of the high

price of gasoline, but the true price is often less than it was years ago. The real increase is in taxes, direct or indirect. But does the motorist know this? He thinks of the great oil companies as exacting every possible penny. No small part of the demand for the socialistic operation of utilities is attributable to misrepresentation or trickery. We would suggest particularly to the utilities that every bill for gas, electricity, telephone service, and for many commodities and services state definitely and conspicuously just how much of the charge is for taxes. Such a policy would make the lot of these companies much easier, give the public a clearer understanding of conditions, and perhaps lead to reform.

The New York City Transit Advisory Commission recommends that both city and state free the bus companies from paying over three and a half million dollars in taxes, so that they can give their eighty-five hundred employees the forty-hour week which they demand, without reduction in pay, and avert a strike which threatens to tie up the city transportation. The proposal is to grant this tax exemption in consideration of an agreement to share all profits in excess of five percent with the city and state.

The proposal is logical and, as far as we know, it is the first serious broad-scale effort to effect a settlement of a labor dispute by freeing the corporation from a crushing tax burden. Specifically, the taxes in question are city taxes, including a two percent utilities tax, a sales tax, and a vehicle tax, totaling \$644,360; and state taxes including another two percent levy on utilities, a tax on gross earnings, and a fuel excise tax, totaling over \$3,000,000.

For such a program there is everything to be said: it is the only sound way to avoid chaos in a complex transit situation. But it would be well to go even further, eliminating all federal taxes, all taxes on franchises, and all real estate taxes on improvements. Furthermore, we question the wisdom of the profit-sharing proposal. A satisfactory transit system is a vital necessity to the prosperity of a city, and its cost must not be excessive. High fares are a serious burden on working people going to their jobs and sending children to school: is there any valid reason for swelling these costs to provide governmental revenue to city, state or nation? Such transportation is a major item in the budget of many a family, and there is no justification for its needless inflation. It is far better to collect the needed revenue from a land value levy, which is deflationary rather than inflationary, and which will not be seriously felt by anyone. Landowners too will

profit by keeping transportation costs down: high transit fares kill real estate values, forcing congestion of population and checking sound and well-balanced growth of the city. We only touch on this proposal here, for it will be more fully discussed when we come to real estate taxation.

In theory, the rates of public service companies are fixed to yield a reasonable profit, providing for adequate service to the public on fair terms and allowing a fair dividend return to owners of the corporation. Should the company clear excessive profits, it would be better to reduce fares rather than to keep them needlessly high as a source of city or state revenue. It would seem wiser, should profits justify such a course, to do three things: (1) reduce charges to the public, (2) permit reasonable increase in dividends, as an incentive to good and efficient operation and to encourage expansion, and (3) increase wages to workers and provide for pensions, retirement, and similar benefits.

New York City is today in a serious financial jam, but it has a wonderful opportunity to blaze the way to real reform which would settle some of these vexing questions once and for all. Working out the same idea as applied to other public services, gas, electricity, telephone, etc., would effect a real saving in living costs and make it easier for the city to collect the ground rents which logically belong to it and which would be notably increased by lower costs of living.

The extent to which we have gone in taxing corporations is seldom realized. American Telephone & Telegraph Company, the greatest corporation in the world, has a gross revenue of \$3,600,000,000. Of this, \$2,500,000,000 went for operating expenses, leaving an operating revenue, before paying taxes, of over a billion dollars. Of this, federal taxes on income took \$330,000,000, other taxes nearly \$300,000,000, making total taxes about \$630,000,000, and leaving a net income after taxes of about \$435,600,000. In other words, a good deal more than half of net operating revenue went to the tax collector.

A breakdown of expenses is illuminating. For maintenance of lines and equipment it paid only a little more than it paid in taxes, and operating expenses, made up principally of wages, amounted to not very much more than taxes. The tax collectors got over \$600,000,000 and the owners of the company received less than half as much.

The corporation belongs to its stockholders, in England more graphically called shareholders. The earnings of the corporation

belong to them and the corporation itself is only an administrative and disbursing agent, operating the business, handling the details, and disbursing to stockholders profits which belong to them. Nearly all taxes levied against corporations, and notably federal taxes on income, although paid by the corporation, actually come out of the pockets of the stockholders.

The first objection to corporate income taxation is that it is double taxation. The income of the shareholders is taxed, first when earned, and again when divided among the owners. It is precisely as if we taxed the little shopkeeper on his receipts when dropped into the cash-drawer and again when taken out of the drawer and put into his pocket. That this is double taxation is undeniable.

This double taxation is no trivial matter. In the case of United States Steel, five dollars goes in taxes for each dollar paid to the stockholder and, in the higher brackets, the personal income tax sometimes takes ninety cents; so out of six dollars the stockholder may get only ten cents, five dollars and ninety cents going to the government.

In the case of General Motors, taxes amounted to over thirteen dollars per share of common stock and took over three times as much as was paid in dividends; and, if we include certain other concealed taxes, the government actually gets about eighteen dollars.

The Sperry Corporation shows a net before taxes of about \$34,000,000 reduced by taxes to something under \$11,000,000, or by about 68%. Taxes absorb between five or six times as much as dividends; and, if the stockholder is in higher brackets and pays ninety percent of the dividend still left to him, the government will get ninety-seven percent.

Another company shows earnings before taxes of over \$6,000,000, taxes close to \$4,000,000, leaving net earnings after taxes of about \$2,500,000. Of this about a million dollars was paid out in dividends and somewhat more carried over as a balance for expansion of the business. In round figures earnings before taxes are sixteen dollars per share; taxes take ten dollars, leaving six dollars per share as net earnings. Of this six dollars, three dollars is paid in dividends and a little over three dollars plowed back into the business.

In the case of Firestone, out of each one thousand dollars about six hundred and thirty-nine dollars go for taxes, one hundred and six dollars for dividends and two hundred and fifty-five dollars are plowed back into the business. The stock-

holder who receives say a hundred and six dollars in dividends, pays at least twenty-five percent in income taxes, so his actual net return is not more than eighty dollars; and, if in the higher brackets, this may be cut to a paltry six dollars and twenty cents. Against this the government collects six hundred and sixty-five dollars; so government gets about seventy-three percent of the "profits."

Admiral Moreell of the Jones and Laughlin Steel Corporation states that in 1951 the total federal income tax paid by the largest companies in each of our twenty largest industries was three times the amount paid to the owners of the businesses. The federal government took seventy-five cents out of each dollar; and then the stockholders generally paid from six cents to twenty-three cents out of their miserable little quarter in personal income tax. Finally, we often have a state income tax cutting into this remainder. Such figures make us realize what a toll is taken from industry. The average tax-payer thinks of himself as paying only the income tax which his own tax returns shows; but, if we see how much has already been subtracted before he even sees it, we realize how heavy is the burden.

It is sometimes proposed that the government shall "withhold" the taxes on dividends to stockholders just as it withholds the tax on wages, but there is a vast difference. The latter taxes, when withheld, are placed to the credit of the wageworker; but, in the case of stockholders, funds which belong to them are simply seized; and now, not satisfied with that seizure, it is proposed to withhold a goodly part of the small remnant of his profits still left to him, to be applied to his personal tax.

There is sometimes a feeling that income from capital investment is unearned income as distinguished from earned wages. We believe that this underlies the double taxation of corporate earnings and the fact that in some states income from investments is taxed at a higher rate than wages. If we grasp the principle that capital is accumulated generally only by self-denial, and by foregoing what consumption wages would give us, as in the case of the boat-builder who goes "fish-hungry" so that he may accumulate "boat capital," it becomes clear that both "fish-wages" and "boat-interest" are the reward of productive labor; but he cannot have both. Whichever he selects will be compensation for work done, and it lies entirely within his control to say in which form he wishes to receive his compensation. However he decides, one is as truly earned as is the other.

Any discrimination between wages and salary or dividends to

stockholders is unethical because it is unjust, and it is unwise because the accumulation of capital does far more to promote the general welfare and to strengthen our economy than does mere spending for consumption. It would be far wiser and far more just to levy these taxes (granting that we must have an income tax) *directly* on stockholders without requiring the corporation first to pay a tax which comes out of their incomes. A policy of imposing the entire tax upon the income of the stockholder would be far more honest because each stockholder would know exactly what he pays, with no concealment and no camouflage. The reason for the present system is, no doubt, that it enables politicians to conceal the amount taken from the pockets of the stockholders. It is extremely doubtful if stockholders of the corporations of the country—and they number nearly seven million—would tolerate such a system if they realized how large a part of their earnings is seized by the tax collector.

In all probability the taxation of corporations will be long continued, for it makes extortion possible. One corporation pays a dividend of three dollars a share, taxes of about thirty-three dollars per share, or eleven times as much as the stockholder gets. Of the three dollars received in dividends in all probability at least one dollar is paid in personal income tax by the average recipient; so out of thirty-six dollars of earnings thirty-four dollars, or more than ninety percent, goes in taxes. If the corporation were untaxed, and paid thirty-six dollars in dividends to its stockholders, who were then taxed thirty-three dollars and eighty-four cents out of this thirty-six dollars, would the people stand for it? It would be too evident what is being done, and such an administration would not long continue in power; but this is just exactly what the government does do. Were the tax paid directly by each stockholder, there would be an almost irresistible demand for economy, efficiency and honesty, to the advantage of everyone.

The practical result of untaxing corporations, increasing greatly their net earnings, would be diffused, bringing benefit to everyone; for it is doubtful if stockholders would grab it all. They would get greater dividends, as they should, and high returns would attract investment in so profitable a business. Employment would be abundant, industry would thrive, and wages be increased; for most businessmen try to be generous and fair. It is good policy to keep labor contented and happy and to avoid strikes. We would have many industries like the Lincoln Electric Company, where the average wage is over \$8,000 a year

and strikes are unknown. Probably, with profits high, prices would be reduced, just as they have been reduced for Lincoln welders, to cite that company again; and it is generally desirable that prices be cut, for this means broader markets. With stockholders getting higher dividends, employees getting higher wages, and consumers paying lower prices, everyone would be better off and individual income tax payments would be greater than ever.

Consider the steel dispute during the Truman administration. The men thought they should have higher wages. The companies could not pay them unless they increased the price of steel, and the increase would tend to upset our economy and add to the burden of taxpayers through increased cost of steel for defense. The problem was aggravated by the meddling of government, attempting to fix prices with an eye to votes. All steel users, including the government, wished to see prices held down, the administration wanted wages increased, and there just was not enough money to go around.

Taxation increases cost of steel without adding one cent to its true value. Thanks to inflation, it costs \$5,000,000 to replace a steel furnace which originally cost \$2,000,000. Cost is the basis of depreciation allowance for the income tax; therefore, the company must find \$3,000,000 over the depreciation allowance, to maintain even its present capacity. The top tax rate applicable to this steel company is eighty-four percent: therefore, to get \$3,000,000 after taxes, the company must clear \$19,000,000 before taxes. How can they do this with a greatly increased payroll and only a scant advance in steel price?

The demand for steel, because of the international situation, necessitates a tremendous increase in production. It is not sufficient to hold our own; it is necessary to run just as fast as we can, like the Red Queen in *Alice in Wonderland*, even to stay in the same place. Under such conditions it is as difficult to expect the steel industry to increase production as it was for the queen to make any progress. What chances has the company of persuading the larger stockholders to make further investments in their stock? It is true that a wealthy stockholder in the upper brackets, perhaps taxed ninety percent on personal income, is not typical of the rank and file, but it is to the richer stockholders that industry must look for investment funds for expansion and growth. And how can the companies hope to borrow the necessary funds on a reasonable basis if there is a prospect of a deficit instead of a profit? It is an insoluble dead-

lock. We cannot hope to have a fair return as long as gross receipts, less taxes, less payrolls, leave zero or even a minus quantity to the owners. There is a plaint from Washington that we are not saving and investing enough to ensure a healthy economy, but is not the answer obvious? Stop unreasonable tax exactions and let business prosper.

Another factor adding to the difficulty was the attitude of the former administration. In that controversy it cited as "profits" the amounts which the companies have on hand *before paying millions in taxes*: it represented as profits \$19,000,000 whereas only \$3,000,000 was left after paying taxes, and it used these *figures before taxes* as the basis of the assertion that the companies can take care of greatly increased payrolls out of their "enormous profits"!

We believe that a progressive tax violates the Constitution and that the income tax amendment does not justify it; but, for the moment, grant that we are to continue to have a progressive income tax and consider it specifically as applied to corporations. Even accepting this principle, there is not the slightest justification for taxing incomes enjoyed by stockholders *according to the size of the income of the corporation*. For such a policy there is no more reason than there would be for grading the income tax of the recipient of a salary or wages according to the size, or wealth, of the corporation paying him. *If we must have a progressive tax, it should be graded according to the income of the recipient and not according to the income of those who pay it*. No sane man would argue that an employee of the AT&T should pay a larger tax on his salary than an employee of the Hicktown general store pays on the same stipend.

There is no relation between the personal income of stockholders and the size of the income of the corporations. The AT&T is the largest corporation in the world, but the average holding of stock is only twenty-nine shares, yielding an annual income of about two hundred and sixty-one dollars. It would not be difficult to find thousands of stockholders in small corporations who receive far larger sums from their little businesses, sometimes a hundred times larger. How these changes would operate is best illustrated by an example.

A certain successful corporation earned, before income and excess profit taxes, over seventy-seven million dollars. These taxes took almost fifty millions, leaving a net return of about twenty-eight million dollars. Of this, the company plowed back into research and development sixteen million leaving about

twelve million for dividends at four dollars a share on three million shares. Had the company been tax free, and had it held the same reserve for expansion, the net income available for dividends would have been about sixty-one million dollars, or something better than twenty dollars a share.

A fortunate and long-headed investor owns thirty-two thousand shares of this stock. With the dividend of four dollars a share he receives a hundred and twenty-eight thousand dollars a year in dividends. Of this his personal income tax—he is in the higher brackets—absorbs ninety percent, leaving him twelve thousand eight hundred dollars net. Were the dividend raised to twenty dollars a share, he would receive six hundred and forty thousand dollars a year in dividends but he would then be in the ninety-two percent bracket; and, after paying his personal income tax, would have left fifty-one thousand two hundred dollars or four times his present dividend.

In contrast, there is a small investor holding thirty shares on which the dividend is a hundred and twenty dollars, all net, for this investor pays no direct tax on his petty income. If the dividend paid were twenty dollars a share he would receive six hundred dollars, or five times what he gets today, and he would still be free from tax obligations. This stockholder would benefit slightly more proportionately than would the wealthy man, and the stock would become a more attractive investment, especially to those who pay income tax in the lower brackets or not at all.

With a rapidly growing and most successful business, the management would also, in all probability, increase its reserves for development and expansion, enlarging factories, developing products, and creating new employment, and it is well-paid employment which would be reflected in personal income taxes paid by its workers.

Taking these facts into consideration, it is probable that relieving this company from taxation, although on the face of it costing the government fifty million dollars a year in tax receipts, would be, largely and perhaps wholly, compensated for in greater personal income taxes of workers and stockholders. Indeed it is probable that, in the long run and with the increasing prosperity which would result if this policy were applied to all corporations, there would be a material increase in the total tax return to the government.

There is a very good argument for untaxing corporations which should appeal especially strongly to our revenue-hungry politicians. For years economists have argued regarding a limit to

which taxation can go. It is held by some that a tax exceeding forty percent is so high that it will be evaded and defeated, but this obviously is not true today when our people have become so spiritless that they pay ninety percent or more without a protest. Nevertheless, there are limits; for if the tax rate is excessive, it will kill off the business taxed. For example, today the high tax on improvements in cities greatly curtails building operations and thus acts to reduce not only the possible tax receipts on improvements but even the tax on land values; for these are dependent upon putting land to profitable use by building upon it.

We do not believe that it is possible to fix a maximum beyond which taxes cannot go, for much depends on conditions and on the character of the people. In the Revolutionary days our people were far more tax-conscious and more high-spirited than they are today; so, although we cannot limit taxes by a mathematical formula, it is self-apparent that a tax levied on business, and on the earning of a heavily-taxed income, will do more to kill the goose of production which lays the golden eggs to support government than will a tax on land values, which will stimulate the profitable use of land and increase our revenue. Long experience shows that a tax on income after it is received has a less blighting effect on productive labor than a tax on the actual earning of money.

QUESTIONS

Should public service corporations be granted exclusive franchises and should they be regulated and controlled?

Are taxes on such corporations ultimately paid by the users of such services? Would untaxing such services reduce their cost and benefit most the wealthy or those of modest means?

Would public ownership reduce the cost of services because taxation on private companies would be saved?

Does the public generally recognize that the larger part of the gross earnings of corporations are taken in taxes?

If dividend income is to be taxed progressively, should the tax increase according to the income of the recipient or according to the size of the corporation through which it goes?

What would be the reaction of the public if they realized that often half of what they pay for telephone service is not for service but for taxes?

Would untaxing corporations give incentive and mean higher profits, more jobs, higher wages, salaries and dividends?

Would untaxing corporations give incentive to expansion, increased employment, and greater incomes to stockholders and employees alike, as well as better and cheaper service to the public?