

## CHAPTER XX

### Corporation Taxation and Cooperatives

#### THE WISDOM OF UNTAXING CORPORATIONS AND A CONSIDERATION OF COOPERATIVES.

*Taxation which falls upon labor as it is exerted, wealth as it is used as capital, land as it is cultivated, will manifestly tend to discourage production much more powerfully than taxation in the same amount levied upon laborers whether they work or play, upon wealth whether used productively or unproductively, or upon land whether cultivated or left waste. The mode of taxation is in fact quite as important as the amount. . . . A tax on date trees . . . caused the Egyptian fellahs to cut down their trees but a tax of twice the amount imposed on land produced no such result.*

*Most of the taxes imposed by modern governments, such as taxes on manufacture, sales, capital and buildings have this tendency to check production just as definitely if not as obviously as in the case of the date trees. They should not be resorted to if any other mode of raising revenue exists.*

—HENRY GEORGE

BESIDES the regular income taxes against the corporations, there was long a tax on excess earnings, on the theory that if a business thrives, much of the increased earnings should be confiscated. This tax was levied on the increase in profit over former years and was a handicap on success and achievement, discouraging expansion. Such a tax is a direct curb on growth and prosperity of business and dries up the source of what is called "venture capital"—namely the surplus funds of wealthy men, normally ventured in new and highly speculative enterprises.

The excess profits tax, fortunately now abolished, bore hardest on small new enterprises. Often the great well-established concern had stabilized its business, with earnings more or less fixed; but the new undertaking, still in the formative stage, looks forward to expansion. This tax penalized growth and development and gave advantage to the big competitor already well established. We should remember that nearly all the great industries were in their early days extremely hazardous. The railroad, the movie, the "horseless carriage," radio, the telephone, nearly everything is at first a gamble, and no sane man would invest in such dreams unless he stands a chance to reap a generous profit should his dream come true—and that was often virtually impossible under an excess profits tax. This particular tax has been

abolished recently; but, since such follies have a way of popping up over and over again, it is well to understand them.

The question will be asked, "Would you let the great wealthy corporations escape taxation?" Yes, definitely: if we must have an income tax, *tax income when received by the stockholders* who are the true owners. Why shouldn't the corporation escape if the stockholder-owners pay? The corporation is only the intermediary—a go-between conducting business, collecting profits and transmitting them to the owners.

The demagogue would object to incomes "getting too high," but would not the long-time effect on the country be beneficial? Even if there were corresponding increase in individual taxes, there would still be far-reaching effects. Investments in such companies will become far more attractive, especially to workers in the companies, who know the business, and to others of moderate means.

Consider this question from another angle. The small stockholder previously described would receive a net return of twenty percent on his stock if bought at par and if he still continues in the tax-exempt bracket. If he bought at the present market, the return would be ten percent if still tax exempt, or about eight percent if the added income makes him taxable. The benefit to the small investor in any case would be enormous and a great incentive would be given to thrift and investment. Such opportunities would bring tremendous possibilities to those of modest means, giving the little fellow a chance to participate in big business, and would doubtless increase greatly the number of stockholders and the prosperity of our people. It is true, and probably desirable, that should earnings reach such figures, some of the gain would make possible higher wages to workers and lower prices to consumers; but this would have little effect on the broad principle that the change would particularly benefit small stockholders.

The same argument applies generally to most other corporation taxes except taxation of land values. Where a corporation holds land for its united corporate purpose, it would be just to tax the corporation on the value of the land so held, for fair ground rent for tenure of land held by a corporation is a legitimate expense. Most other taxes levied on the corporation are unjust, and it would be better in nearly every case to eliminate these taxes and tax the shareholders and not the corporations. Possibly another exception should be made in the case of a tax on pay-rolls, if we must continue to penalize the giving of employment.

It would, however, be wise, if we are to provide such "security" to favored classes of workers, to raise the funds by a general levy on all our people, for there is no reason for imposing the burden on those who today give employment, while those who have never given a job to anyone go free. Generally the worker pays much of this tax and it often means lower net wages.

Another vicious thing in corporate taxation is taxing undistributed profits which, instead of being paid out as dividends, are plowed back into the business. The argument is that, if profits are retained and put back into the business, this policy may be resorted to to prevent paying income tax on a considerable part of the profits; but what of it? It is highly desirable in many a business that the company should reinvest much of the gain in expansion, development and research. It develops new industries and means more employment and bigger wages, and such policies result in greater income both to workers and stockholders to be taxed in future years.

The management of a corporation should be left to the management: they can best judge whether profit should be paid out in dividends or should be reinvested; and, if they do not play fair, let stockholders take matters into their own hands. It is something in which the government should not meddle. Assume that an investment of a million dollars in research will yield an eight percent return: then there will be an increase in stockholders incomes of eighty thousand dollars. But suppose, instead of meeting this expense from accumulated profits, the corporation borrows two million at three percent. This earns eight percent—a hundred and sixty thousand dollars—and of this, sixty thousand dollars goes in interest, leaving a hundred thousand dollars clear velvet. Under the first plan, stockholders will forego one million in dividends, but future annual income of the company will be increased by eighty thousand dollars subject of course to taxes. Under the second plan it can do twice as much research, increase gross annual profits by a hundred and sixty thousand dollars, and *payment of interest can be deducted from taxable income.*

Clearly the second plan is most advantageous. That it actually works this way is evidenced by corporation reports which show that in recent years, with mounting taxes, a greatly increased proportion of expenditures for new business, for development, expansion, and research is being met by borrowing rather than by the sale of stock or from reserved earnings. This is unfortunate: it is wiser to encourage expansion directly by the owners rather

than by borrowing, for economic life will be made sounder and stronger by increasing ownership of industry rather than by expanding through borrowing.

Another objection to taxation on excess profits is that it encourages foolish and reckless expenditures charged to expenses and deductible from taxable income. Apparently it is common practice for some corporations, instead of increasing salaries to traveling representatives, to wink at reckless extravagance, padding, and even downright dishonesty in expense accounts. Ridiculously luxurious accommodations at the most expensive hotels, club memberships, entertaining and theaters on a prodigal scale, are all a matter of course, or at least are charged, as well as many items which are obviously fictitious, to the benefit of the employee; for refunds of business expenses do not constitute taxable income as would a salary increase.

These all constitute business expense deductible from income before computing taxes. They therefore are offset in large measure in tax savings, sometimes only thirty to forty percent actually coming out of the company. As for the employee, since they are theoretically only reimbursement for what he has paid out as business expense, they are not income and therefore they are not taxable. This is just an example of what a bad tax can do at corrupting people and breeding dishonesty.

These tax policies also lead to such follies as extravagant advertising. It is argued that if sixty-two percent or more of increased earnings will go directly or indirectly to the tax collector, it may be just as well to indulge in a spree of advertising, which may be well worth the thirty-eight percent of advertising expenditures, which is all that it sometimes costs. This has gone so far that there is under discussion a proposal to restrict advertising of corporations, to prevent spending money which would otherwise go to the tax collector. We are not discussing advertising, but we do say that it is the height of folly for government to meddle with business management and practically say, "Spend a million dollars in advertising or the government will take six hundred and twenty thousand dollars away from you."

In these days when we hear so much about inflation, it is strange that more is not said about the inflationary effect of our tax policies. Consider some taxes, which we all pay directly or indirectly on electricity, gas, telephones, travel by any conveyance, telegrams, and amusements. Does your electricity give any better light because light bulbs and electric service are taxed? Does gas cook your food any faster because you pay a tax on

it? Does the telephone give better service because the AT&T pays about three dollars each month in taxes per instrument? Incidentally, and as a sidelight on tax trends, it may be worth noting that, in a book by the writer published in 1935, this figure was given as fifty cents: when work on this book was started in 1951 it was two dollars and sixty-five cents and in 1953 it was three dollars and twenty cents. In recent years there has been a slight easing of the burden. Surely the company cannot be blamed for increasing rates when practically all the increase is absorbed in taxes. We wonder if the telephone-using public would continue to tolerate such taxation if they realized that half the charge made by the company may be actually a tax which, in the long run, must be paid by the users.

Taxation adds nothing to the value of these services: on the contrary, these taxed services are less utilized. You burn fewer lights, send fewer telegrams, go without a telephone, go to fewer places of amusement, take fewer pictures and fewer trips because of the increase in cost resulting from taxation. All the businesses concerned suffer, for tax rates raise the cost of what they have to offer and thus curtail markets, confiscate profits, and may even ruin the business, adding up to a lowering of our standards of living. Indeed this is an end sometimes desired and openly sought by some of the extremists. For it there are two arguments to some minds. First, by making business as unprofitable as possible, they seek to force this nation into socialism, and second, it is sometimes argued, although fallaciously, that taxing our people in such ways as these will keep us poor, curb spending, and do something to limit inflation. Of course this argument is nonsense, for money collected in taxes and spent by the government is spent and creates demand just as truly as if it is spent by the man who earns it.

It is quite possible that the motive back of such power development schemes as the TVA and kindred programs is to force socialization on these industries. Indeed at the present time, when there is a row raging about generating electricity for atomic use, this seems to be the impelling motive of those who continue to urge socialization. Make private business in these fields profitless: then the government will step in and supply the service. Doing this, the cost will be far higher than under private enterprise, for government operations are always inefficient and costly; but these costs are concealed in tricky ways and met by higher taxes. Such operations enable the government to keep down the ostensible price of electricity just as they keep down

the price of postage; when they do, meeting a great deficit by an appropriation from money paid by the taxpayers.

The taxation of corporations has the direct result of crippling industry, and were we to impose the burden directly on the stockholders, their personal tax would not act nearly as strongly as a deterrent to industry. The individual citizen would often suffer, but no more through paying a high tax himself than by paying a double tax; and the small investor would be better off. Such a change would result in the diffusion of stock, more people of limited means acquiring a share in great, prosperous companies. The companies we have mentioned have bonded debts, in some cases very large debts, and some are figuring on increasing these debts to provide for necessary expansion. Were these companies free from taxes, their net earnings would be greatly increased and their stock would become so desirable that there would be no need to borrow. Expansion could be paid for out of earnings and new stock could be easily sold on a basis profitable to all. Such a course would mean a great expansion of our industrial life, more jobs, greater prosperity and higher incomes to all our people.

The untaxing of corporations would eliminate a troublesome problem. Today, under a policy of encouraging cooperative associations, "co-ops" are tax exempt, escaping taxes of a billion dollars which they would have to pay if they were taxed as are corporations. But all corporations are cooperative organizations, where many unite to operate as a unit, and it is far from easy to draw an exact line between cooperation and incorporation. Many large enterprises, operating as cooperatives conduct a business exactly like that of many corporations and untaxed, compete unfairly with their taxed rivals. One large cooperative operates in six states in a variety of industries and escapes a tax bill of nearly a million and a half which it would pay as an ordinary corporation. Many business concerns follow the cooperative pattern for just this reason. We have no quarrel with their escape from taxation—that is as it should be—but it is only just that competing corporations should be treated in the same way with no distinction or discrimination based on a technical form of organization.

The argument for preferential treatment of co-ops is generally based on an understandable desire to eliminate outside capital and management with its attendant expense. Let the members carry these responsibilities themselves and return the resulting savings

to the producer in a higher margin of profit or to the buyer in lower prices.

The trouble with this argument is that it just doesn't work. Capital expects and merits its reward, and there is seldom any economy in merging the functions of the executive or of the capitalist with those of producer or consumer. Experience shows that rather the reverse is true, for an outsider often operates more efficiently and economically than can a producer whose training is along other lines, or the consumer who has other interests.

Where the business is simple, cooperation sometimes works. College co-ops, selling goods to college students, are often successful but large cooperative department stores seldom are. The college store handles a limited variety of merchandise, and their customers are regimented in needs and desires, often of nearly the same age, wearing the same clothes, studying the same books, engaging in the same sports and hobbies. To buy for them and to sell for them is comparatively easy, for everything is standardized. Often, too, these stores have a very real advantage in an exclusive campus location. This is all very different from operating a department store in a great city, selling to all classes, selling every kind of goods, and catering to widely varied tastes.

The writer has had some experience with agricultural co-ops. Some, generally in specialized lines, have succeeded; but many have failed, often from the lack of business experience on the part of the members who often undertake management. The farmer, skilled in the technique of his own trade, often lacks experience and training in finance and business. Frequently, too, he resents the fact that a good executive commands a salary greatly in excess of the farmer's earnings. This was forcibly brought home to the writer in connection with a big agricultural co-op. The business was promising and things looked bright, but it didn't go too well. The volume of business was just about the same as that of a widely known railroad system; and, in the opinion of experienced financiers, the business was far more difficult and complex. The salary of the railroad president was ten times the salary of the co-op president and the relative merits of the two men were about in proportion to the salaries they received. When a proposal was advanced to increase greatly the salary of the co-op president, and endeavor to secure a more capable man, it was snowed under; for farmer members felt that the president was already getting far more than most of the members were making and that he should be content. The result was just what might have been expected. The mediocre pres-

ident was unequal to the task before him; and before long a complete reorganization, which was practically a sell-out, became necessary.

In an essentially simple retail business it is doubtful if cooperation offers any great advantage. The savings are often very petty, for business is done on a narrow margin these days and the rebate to customers is often a trivial matter. We wonder if to a certain degree this principle of profit-sharing is not accomplished as efficiently and as satisfactorily under various schemes of commercial business. Direct refund, discounts, special offerings, trading stamps, coupon and premium plans, bonus books of the book clubs, and similar devices illustrate schemes which accomplish the same purpose; and while we do not like such devices, we question whether a petty cash rebate is much more satisfactory. The writer is himself a member of one of the large cooperative organizations and gets every year a small rebate check, but the amount is so trivial that it does not pay to go out of the way to buy from the cooperative. We find, too, that the management is less efficient than in competing stores where we often get better service and a broader variety of goods.

There is a feeling that co-ops will eliminate the "middle man," but the benefits are often disappointing and it is generally hard to see any great advantage in cooperative organizations. If cooperatives are to be encouraged and favored, which the writer would question, then special advantage should be conferred only on true cooperatives and not extended to those which operate in practically the same way as any business corporation. In our opinion, between the two forms of business organization there is not difference enough to justify discrimination. Is there any good reason why, when a group unite as a cooperative to transact their own business to their own advantage, they should expect concessions and privileges denied to those who unite as stockholders in similar business associations? It is true that sometimes the cooperatives make a much better showing than independent business; but, when statements are analyzed, it is generally found that the advantage results mostly from tax advantage.

The transfer of the tax burden from the corporation to its owners, who must pay it anyway, would go far to eliminate this confusion even if the amount today extorted from the corporations were collected from the stockholders as individuals. The problems of the corporation would be simplified: there would be funds available for expansion, and labor troubles and strikes would be largely eliminated. There would also be other benefits;



we would get rid of a great deal of the opportunity of government to interfere with corporate management, eliminate a temptation to corruption, and have direct and simple contractual relations between employers and employees, adjusted without political meddling.

Such a change would result in the diffusion of stock, more people of limited means acquiring share in great, prosperous companies. The companies we have already mentioned have bonded debts, in some cases very large debts, and some are figuring on increasing these debts to provide for necessary expansion.

### QUESTIONS

To whom do the earnings of a corporation belong?

Would elimination of the taxes on corporations benefit the stockholders?

Is the taxation of the earnings of a corporation, and the taxation of the same earnings when paid out in dividends, double taxation?

Would untaxing the corporation encourage expansion and development, giving greater employment, higher wages, and greater returns to investors?

Is there a chance that, while untaxing corporations would result in a loss of public revenue, this might be largely compensated for by the increased incomes from wages and dividends which would be taxable as personal income?

Would the probability of one balancing the other be increased by the fact that such a policy would give great incentive to industry?