Infernal Revenue: 1940 Style

By ISIDORE PLATKIN

The year 1940 was noteworthy for the passage by Congress of two tax bills instead of the customary one. By the terms of the First Revenue Act of 1940 a vast number of individuals formerly exempt will become subject to the income tax laws.

The exemption for single persons was lowered from $1,000 to $800 and for married persons from $2,500 to $2,000. Surtax rates were increased in the $6,000 to $100,000 brackets. In addition, as a temporary measure for five years, there will be levied a super-tax amounting to 10 per cent of the regular income tax. The rates on corporation incomes were increased; so also those on gifts and inheritances.

Practically all commodity and excise taxes were raised by approximately 10 per cent. The tax on a package of cigarettes was increased from 6 to 6½ cents, and the 10 per cent on admissions was applied to charges of 21 cents or over, instead of 41 cents or over as under the old law. Liquor taxes were raised from $2.25 to $3.00 per gallon.

The Second Revenue Act of 1940 provides primarily for a tax on excess profits of corporations, and an increase in the normal income tax rate of corporations earning in excess of $25,000.

The effects of increases in the commodity and excise taxes are of course too obvious to require much detailed discussion. All such taxes lower purchasing power and lessen demand and consequently production. A slow-down in production means partial or complete unemployment for many persons, which calls for more relief and hence more taxes. So we swing merrily around the vicious circle. If the year were not soon drawing to a close, we might almost predict a third revenue act of 1940 as a consequence of the other two.

Many believe that since the tax increases on commodities are relatively small they cannot seriously affect purchasing power. They forget that to the individual of small income a federal tax on cigarettes of 6½ cents per pack, in addition to local taxes, is a real burden. If he consumes a package a day, the half-cent increase alone during the course of a year equals the price of 15 quarts of milk. Of course, if his cigarettes deprive his children of milk, he should not smoke. Perhaps then the revenues would have to be supplemented by a tax on milk. It would not be the first time that a primary food was levied upon by the tax gatherer.

So it is, too, with the needy farmer or share cropper, driving to town in his "jalopy" for food or supplies. He literally counts his income in terms of pennies. Every cent of gasoline taxes is a serious matter to him. The federal tax is now 1½ cents per gallon—this besides the state taxes.

Some students of taxation have long favored a reduction in exemptions in order to increase the number of income tax payers. The theory is that this would make the people more tax conscious, which is certainly true. But if the only purpose is to increase their awareness of the taxes they pay, then by all the rules of justice and fairness, in order to offset the increase in income tax rates, indirect and hidden taxes should be lowered. We see that such taxes have actually been increased. The conclusion to be drawn is that the principle of a broadened tax base is nothing but a red herring; the only purpose of lowering the exemptions is to obtain more revenue.

A widely held belief is that income taxes, being direct, cannot be "passed on." This view is not entirely correct. Income taxes, it is true, cannot be added to the cost of production. If prices were determined solely by the cost of production, the principle that income taxes cannot be passed on would be perfectly sound. But the fact is that prices, though influenced by the cost of production, are ultimately determined by competition in the market. An income tax, by lowering the net returns from production, acts as a deterrent to production and thus curtails supply. And a decrease in supply is just as effective in increasing prices as is an increase in production costs.

Some of the most bitter debates in Congress on this year's revenue legislation centered around the Excess Profits Tax bill. Like all revenue bills, it had as its primary purpose to obtain additional tax receipts. A secondary purpose was to prevent the rise of new millionaires as a result of the defense program. An examination of the act indicates that it may succeed in this latter purpose, but two questions immediately present themselves: (1) Why is it desirable to limit the number of new millionaires, and (2) Why favor the

old millionaires?

Much of our tax legislation seems to be predicated on the theory that there is something unholy about profits. Is such a belief based on sound social philosophy and correct economic reasoning? Profits can come from only two sources—production and privilege. Every dollar of profits from production implies the previous rendering of an equivalent in goods or services. Such profits should be inviolate against every individual, every group and even the government itself. It should be the aim of society and the government to encourage rather than to restrict profits from production; thus production itself can be encouraged, with an increase in the wealth of the poor and needy as well as the rich.

This is no mere plea for the millionaire. It is a moot question whether any one can earn a million dollars as the result of his own production. But whatever be the absolute limit of profits from production, they cannot be earned at the expense of others. On the contrary, they increase only in proportion to the values offered and the services extended.

Profits arising from privilege are another matter. Just as there is no justification for the government's confiscating part of the profits from production, so there is none for leaving any profits from privilege in the hands of individuals. Profits from privilege enjoyed by some are obtained at the expense of the rest of the community. Such profits as these constitute the rightful basis of taxation.

Here we see the fundamental fallacy of all our income tax legislation. Save for the relatively unimportant earned income credit which applies only to individuals and not to corporations, no distinction is made between sources of profits. For the sake of accuracy it should be pointed out that the new tax law does exempt from the excess profits tax certain corporations defined as personal service corporations. But the taking of such an exemption may well prove to be a case of jumping out of the frying pan into the fire. For exemption can be obtained only if the stockholders agree to include as dividends on their personal income tax returns their porportionate share of the corporate profits, even if they do not actually receive such dividends. And the exemption applies only to the excess profits tax; the normal corporate income tax must be paid in any event.

The new law was designed to limit or prevent the creation of new millionaires. It levies a graduated tax up to one-half on excess profits of corporations—defined as all profits in excess either of 8 per cent of invested capital or of 95% of the average earnings for the years 1936 to 1939. Now, in a competitive society, very few corporations earn 8 per cent on their invested capital. It follows that in the case of most corporations, earnings in excess of 8 per cent, even if they follow several years of losses, will become subject to the excess profits tax. On the other hand, corporations which in the past have received disproportionately great returns on their capital will be exempt to the extent of the average of such returns from 1936 to 1939. Paradoxically enough, these as a rule are the very corporations which should be taxed the most. For returns in excess of 8 per cent, consistently received over a period of years, are generally the result, not of production, but of monopoly and privilege.