

FEDERAL TAX REFORM*

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THE BUSINESS leader, objectively at least, is a very inhibited and circumscribed social animal. He can seldom speak frankly or candidly on any important and, to him, interesting subject. Some statements might impair the morale or loyalty of his own executive organization; others might make his labor leaders more aggressive or intractable; others might stir up sleeping dogs in the anti-trust division or alienate some important chancellor; others might facilitate unfortunate legislation or even revolt among his stockholders. Thus, he is nearly as limited in his range of feasible subjects for candid talk as is the diplomat or Senator. But he can always talk freely about taxes. It's always open season on taxes. Everyone gripes about them and loves it. Thus, if one happens to be speaking out of a background of exasperation with a business agent or the SEC, the natural outlet is a diatribe against taxes, especially on capital gains.

The everlasting concentration on capital gains also deserves half-serious analysis. This part of the tax law has, in fact, very little importance for business as such, though it did earlier involve some flagrant anomalies in corporate taxation; and its adverse effects on individual investment behavior, if real, are of little or no concern to the kind of corporations whose executives harp on it in their speeches. The plain fact is that these folk don't like extreme progression. I agree with them (although for reasons they would largely reject) that it has, at least in peacetime, gone too far. But my interest in the matter is quite academic, while they are men of action, and of practical action. Now practical action, since the days of Mr. Mellon, does not include attacks upon the surtax *rates*. Frontal attack is useless if not suicidal. But there is a weak spot at Section 117. No one understands it; most ordinary mortals have never experienced a capital gain; reputable lawyers and accountants will, amidst a flood of jargon, assure Congressmen that such gains are capital accretions and not income at all; financial editors will cooperate to a man; and at the politically crucial moment, *The New Republic* will print an article or editorial which will assure all doubtful souls that the issues are really very complex.

* This article is prepared from an unpublished manuscript written by Professor Simons in 1943. For further details, see the foregoing comment, Director, Simons on Taxation, 14 Univ. Chi. L. Rev. 15 (1946).

Such, at any rate, is the *Realpolitik* of taxation. If you don't like your surtaxes, look for loopholes in the tax base. If no adequate ones are found, write to your congressman about capital-gains taxes and tell the world that they are ruining business. Don't waste breath on the surtaxes. Face the problem realistically (but never frankly) for what it is, namely, a shortage of convenient loopholes. And don't worry about ruining the tax base. It's full of holes already. What's needed are holes to suit our special needs. Only talk is necessary to create or to enlarge them. How else can we talk usefully these days?²

REALIZATION PROCEDURE: CAPITAL GAINS AND
UNDISTRIBUTED EARNINGS

Two prescriptions for good income-tax accounting or procedure may be suggested. First, it must be a logically closed system, free from gross inconsistencies. There must be no loose ends. There must be no arbitrary exclusion of relevant income items, positive or negative. All data important for determining relative personal incomes must be brought into account. Any feasible system, to be sure, must contain some arbitrary elements or concessions to practical convenience. Consequently, the best system will occasionally favor some taxpayers relative to others. Fortuitous minor inequities cannot wholly be excluded; but there must be no opportunities for deliberate systematic avoidance on a large scale, i.e., for altering substantially one's tax liabilities without change in one's real income circumstances.

Second, good procedure must not require or presuppose sharp allocations of income among short accounting periods or fiscal years. Tax levies must be inequitable if graduated according to the fluctuating personal incomes of discrete years. What here merits emphasis, however, is that precise determination of relative incomes in successive years is inherently impossible; and that tax legislation calling for definitive annual determinations means awful complexity, difficult administration, expensive compliance, endless litigation, and bad taxpayer and Bureau morale. Like it or not, we must recognize that good income taxation is not merely a succession of events in or respecting discrete, watertight accounting periods but

² The serious aspect of this situation is not the behavior of businessmen but something one might call the sociopolitical aspect of excessive progression—excessive in the sense of being nominally more severe than that which political opinion will effectively support. The blame lies with Treasuries which propose, and Congressmen who vote, surtaxes higher than they will *try* to implement by closing avoidance loopholes. The real trouble about tax-exempt securities, as about capital gains, is that responsible politicians feel just like the tycoon, viz., that *rates* are too high and that the politically feasible way to lower them is by maintaining substantial avoidance opportunities.

is essentially process through time. Its objectives must be defined and pursued with respect to long periods, often the taxpayer's whole lifetime.

Look now at the actual situation, as legislation and business practices have made it. There are many large loopholes. (Ignore tax-exempt securities, residence income, and such things for the present.) "Unrealized" gains on property held until death are completely excluded, as are, of course, unrealized losses. Gains accrued in the hands of donors never affect their taxable incomes. Gains of donors may (anomalously) be taxed to donees—usually at lower rates than they would have paid if taxed to the donors; or the donees may die seized of the donated property; or, at least, they may pass the specific properties on interminably to other donees. Even realized gains largely go down the drain, untaxed to half their amount (Section 117).

Likewise, present and past law, while embracing accounting practice, highlights its infirmities and pardonable shortcomings and leans ponderously upon the empty spaces of its *lacunae*. It seeks a precision and finality in inherently provisional determinations which can only drive accountants into distraction, courts into sophistries, and tax lawyers into pestilential multiplication. Thus particular gains are arbitrarily allocated between high-rate and low-rate years (years when the taxpayer's other income is high or low—not to mention statutory rate changes), and loss deductions similarly. Property becoming worthless may give rise to loss deductions only if one guesses precisely the moment when, according to changing fads in legalistic fictions, it "actually became" worthless. Depreciation deductions may be lost entirely if made, for a time, at less than "the proper" rate; and the "basis" must be written down by the full "correct" amount even though there is currently no positive net income to absorb the charge—a sound rule for published statements but bad for income-tax accounting. Sheer guesses about obsolescence must be "annually correct"—with high-handed administrative last-guessing (usually worse than the taxpayer's) at "correctness." The fact that depreciation has not been taken or that guesses have been too low does not entitle the taxpayer to deduct subsequently a greater amount for depreciation than would *otherwise* be allowable (i.e., than initially "correct" guesses for the whole life of the property would have imputed to each subsequent year!).

The law thus seeks meticulous short-term precision in a practice compounded of such rule-of-thumb devices as cost-or-market inventories (not to mention that monster child, Lifo!), straight-line depreciation, "hunch" obsolescence, and other accounting practices whose main justification or apology is that, *given time*, they may work out well enough "for all practi-

cal purposes." It incorporates a process whose annual output is inherently arbitrary and essentially provisional estimates, and then treats these estimates as definitive and final. This is most obviously and sadly true, to repeat, of annual charges for depreciation, depletion, and obsolescence, which are mainly sheer conjectures. It is also very strikingly true, as we shall note later, of all transactions between a corporation and its shareholders. Income taxation has simply never faced squarely the axiom that annual-income accounting is and should be tentative and provisional. Accountants long have recognized it, of course, in the practice of by-passing the Income account with direct charges and credits to Surplus or Undivided Profits.

The broader consequences of the loopholes may be indicated more concisely than those of arbitrariness in time-allocations. They frustrate the central purpose of income taxation, namely, equitable progression—whether with progressive rates of tax or merely with the “degression” of exemptions and a flat marginal rate. They discriminate grossly between property incomes and salary incomes; between wealthy and less wealthy persons; between real business enterprisers and stock-market “operators”; between these relatively useful operators and the passive, diversifying “rentier stockholder”; and, notably, between shareholders and partners or single proprietors. They have some adverse effects on the “orderly marketing of investment assets,” tending slightly to aggravate an otherwise alarming technical bias in securities markets against short-trading and bearish influence—although these effects have been exaggerated and misrepresented. They doubtless discourage, and sometimes prevent, transfer of enterprise ownership and control from unwilling, irresponsible, or unenterprising owners into better hands. Certainly they penalize a much-to-be-desired movement by able and venturesome enterprisers, from firms as they become established, proven, and mature, on into new uncertainties or innovations.

In its rigid, skeletal form, our scheme calls for continuance of traditional realization accounting, with the addition² only of “constructive realization” by donors and decedents at time of gift or death. The idea is simply that property should never get out of an owner’s possession without a final gain-or-loss reconciliation by or with respect to that owner himself.

The appraisals required under such reconciliation are already required for gift tax or for estate tax, inheritance taxes, and probate. Moreover, they are also now required for determining gain-or-loss bases of benefi-

² Save for some averaging device (rebates), which is imperative for fairness under any procedure, and only slightly more important under our procedure than under any other.

aries—and might much better be finally determined for this purpose at the time of transfer, and as a matter of formal contemporary record in tax returns, than left for bad guessing later when the beneficiary (or donee's donee) happens to "realize."

If one be distressed about inaccuracies in appraisals, one may be consoled, if not completely reassured, by the fact that the benefactor's "realization" will later be the beneficiary's "basis." Even with essentially fraudulent initial appraisal, the error will be offset, not only ultimately but at the very next transfer—unless one supposes that the first fraud means a still more fraudulent second declaration of value than otherwise would have occurred.

If one deplors the concentration of tax liabilities at time of death, two rejoinders are in order. First, the taxpayer need not let his unrealized gains pile up at death unless he deliberately chooses to do so. Our procedure, like present law, leaves the timing of realizations wholly to the taxpayer's discretion. Moreover, in the less rigid application we strongly recommend, it would leave the taxpayer free to realize without any sales at all, i.e., free to use all his bases as his very own. Most taxpayers doubtless would prefer to keep their accrued gains pretty well "cleaned up," i.e., to report income and to write up their bases into proximity with changing probable realizations. Thus, they can minimize liquidity problems and avoid larger income-tax liabilities for their estates, while also avoiding a death glorified by ascent into unfamiliar surtax brackets. Other taxpayers, zealous, active enterprisers to the end, and intent upon personality realizations of sheer activity and power, may prefer to let their gain-accruals pile up, conserving capital for business expansion during their lives and not caring much about losses to their heirs, either from too rapid liquidation or from high post-mortem surtaxes.³ Seriously, I assert that income-tax procedure *should not* discriminate between these two kinds of people. (If St. Peter discriminates sharply, that's his responsibility.)

Second, the deploring may imply that death duties are too high—if not, as construed more literally, that all inheritance taxation is inherently

³ Here again one anticipates the pedant's solemn demurrer about letting taxpayers speculate with the government's ("the people's") money. This bit of heckling always has some rhetorical effect; it may even score a triumph for the debater. The implied argument flies squarely in the face of averaging considerations. These penny-pinchers and soap-box moralizers would have the Treasury *go out of its way* to penalize taxpayers with fluctuating incomes. Moreover, (what is even more important) they would, while unaware of or unconcerned about the adverse effects of progression on enterprise and incentives, blithely throw away all of its favorable effects which, if not fully compensating, certainly are substantial. If we can do anything positively to stimulate enterprising private speculation with (what is *parily*) potential tax revenue, we certainly ought to do it without limit, if the only costs or disadvantages are those implied by the penny-pinchers and speculators-to-hell-committers.

intolerable and, indeed, that arrears of property tax or water bills ought not be collected from the same place as undertakers' charges. Perhaps our actual death duties are too high, although actually far lower than they should be *if* anyone should ever find and sell a technically sensible procedure or concrete principle of levy for taxing inheritance. Certainly they are too high for the anomaly-infested expedients which are the extant death levies. When we learn *how* to tax inheritance, difficulties of right-of-way may arise between income and inheritance taxes. For the present and probably for a century, death duties must give way to the income tax, for the latter already has attained, or approximated, a sound procedure and sound tax base. *If* our scheme would unduly concentrate tax liability⁴ upon estates, the difficulty should be met by changing the estates tax, not by restoring income-tax loopholes and anomalies.

If realization procedure were tied together with constructive realizations at time of gift or death, the taxpayer might be given wide latitude in using his gain-and-loss bases and allowed to use them, for taxation purposes,⁵ as he pleased. At some points, we have suggested that he might treat it as his very own, subject only to the requirement of ordinary honesty, i.e., of technical integrity in his bookkeeping. This is admittedly an extravagant and deliberately challenging statement. Frankly, I should like to see how far one must retreat from this polemical outpost to reach a secure and defensible position! There is no need for inviting attack by such temerity; one doesn't need this outpost to defend our main position or to assure successful attack on other positions; but overstatement is a useful means for promoting fruitful controversy or serious, vigorous discussion. One needs help in assaying novel schemes, especially his own.⁶

One senses some dangers in a *carte blanche*; but most of one's particular misgivings turn out to be unfounded. A person might, you say, alienate all his property and leave the Treasury holding the bag, i.e., holding a penniless surtax-payer. But the alienation itself precipitates the tax liability; and no serious difficulty should arise in making the tax liability follow the

⁴ In any case, there is no "double taxation." Income-tax liability would reduce the net estate, which is the death-duty base.

⁵ The need for something like present income-tax restrictions for other purposes would, of course, remain, e.g., for the published statements of corporations.

⁶ I am not enough of a scholar to pronounce upon the novelty of any ideas or schemes expounded in this essay—but have yet enough second-hand acquaintance with scholarship to feel confident that all of them have been expounded frequently at one time or another. I hope what I'm writing makes sense and see no reason for not writing sense for fear that bibliophiles will point out an army of unacknowledged precursors. The only person, by the way, to whom I feel substantial indebtedness for my insights on income taxation (such as they are) is my undergraduate teacher in Accounting, Professor W. A. Paton.

property or, better, the beneficiary, for the necessary short time. No system can hope to be completely foolproof against sheer fraud.

Again, the taxpayer's estate might lose so heavily in liquidation, because of depleted "bases" and concentrated realizations, that the Treasury would come off badly. But the proceeds of liquidation are certainly strong presumptive evidence (fraud again apart) of values at time of death. Thus the Treasury, demanding excessive income tax on the basis of extravagant appraisals ("constructive realization"), might conceivably be foiled by consequent insolvency of the estate—which would be hard on the heirs but hardly unfair to the Treasury.⁷

Again, a taxpayer, you say, might exhaust his bases ("spend" them recklessly) and thereby become so heavily indebted contingently to the Treasury that he would have little interest in conserving his property or estate. But he faces no threat of bankruptcy on account of this potential tax liability, and thoroughly solvent debtors are seldom notoriously irresponsible. Besides, what is really important is not total contingent liability but marginal rates of tax. If serious cases of the kind in question should become numerous, the significant implication would be, not that the procedure was wrong, but that surtaxes were excessively high. No procedure can guard effectively against that political contingency.⁸

A difficulty may arise—i.e., be slightly aggravated under our scheme in its extreme form—when taxpayers systematically consume their capital not by selling assets (which would precipitate the contingent tax liability) but by borrowing on a rapidly increasing scale against "low-basis" property. Such behavior is, of course, also a bit annoying to the Treasury *qua* collector of estates tax; and it is hard to see how rare messes can wholly be avoided, especially if irresponsible lenders are available. But methinks all this is trivial—which should suffice to persuade the reader of our blind-

⁷ The issue really implicit here is the same as that discussed in note 3 *supra*. Many people really suggest that the Treasury, besides keeping cards in its sleeves, should drop out of its little poker game with the taxpayer whenever its chips have piled up a bit. Now such behavior certainly doesn't make friends for Treasuries. Moreover, it is precisely contrary to the public interest in fairness among taxpayers and in business incentives. "Taking profits and cutting losses" may be good practice for speculators who have no business speculating at all. It is a silly rule for tax procedure, for the Treasury surely must take some risks *with* the taxpayer risk-taker if there is to be any private risk-taking and enterprise. We are really much too tolerant toward fool talk on such questions and too skittish about critical attacks whose only ammunition is half-plausible foolishness. Students of taxation, like golfers, need to keep their eye on the ball or, at least, to know approximately which is the ball.

⁸ And we only plunge deeper and deeper into an insufferable mess—and thereby jeopardize our only good tax—whenever we *try* to mitigate excessive rates or excessive progression *procedurally*, i.e., by special, particularist immunities or dispensations. (See, *inter alia*, the section below on Depletion.) Perhaps the worst example of this political practice is the use of Section 117 primarily as a means for lowering the top surtaxes.

ness to the real shortcomings of a proposal which we suspect of going too far.

On one point, however, further inquiry seems unnecessary. There is no occasion (excepting always the case we have reserved for later consideration—namely, *predictable* rate-changes) for misgivings about *carte blanche* to *increase* bases, subject always to accounting integrity, i.e., to the necessity of adding equally to current taxable income. If a taxpayer thus achieves bases far in excess of the most generous possible appraisal, the Treasury might well slip in a good word for psychiatrists, or even suggest guardianship to the taxpayers' dependents. But there would be no very plausible grounds for action to protect revenues, save possibly when a war is looming ahead.

Extravagant downward basis-changes arouse more relevant suspicions, especially during high-rate years or in the face of predictable rate reductions. They also suggest impecuniousness or skulduggery. But, fraud apart, it is hard to see how revenues or fairness could seriously be jeopardized.

Coming at the whole question from another angle—it surely is desirable that bases should roughly correspond with the ascertainable facts and best guesses about real contemporary values. Other things equal, tax procedure should not widely depart from the standards and practices of, at least, the most enlightened and least hidebound business accounting and accounting doctrine or, among others, SEC requirements. One is perhaps disposed to overvalue the sheer simplicity, elegance, and flexibility of the *carte blanche* option. Acquaintance with past law and practice, especially among Bureau employees, surely disposes one, seeing an escape, to run too far. Certainly the past confinement must impel taxpayers, and empathic observers, to get as far away as possible. But is so much freedom, freedom to do essentially foolish things and to repudiate even the most generous accounting standards, desirable—even if there be no need to worry about protecting the revenue or avoiding relative unfairness? Our tentative answer is a diffident and regretful “No.”

All that is needed is a radical loosening up of legislation, of the Regulations and of administrative requirements and small-Bureaucrat dictation. In general, the burden of proof, in cases admitting of doubt or reasonable difference of opinion, should be transferred from taxpayer to the government (Bureau). For securities, no basis-change should be open to objection by the Treasury if it admittedly leaves the basis within, say, 10% of current-market or fair-appraised value. For depreciation, depletion, or obsolescence, no charges should be questionable, or annoyingly ques-

tioned, if they are within reason, according to engineering appraisals, accepted accounting practice, or the opinions of reputable accountants or auditors. Specific "rules" should be laid down, if at all, only as flexible, normative guides for the more typical cases, with wide latitude for taxpayer discretion.

Of course, once we depart from *carte blanche*, it is difficult to indicate clearly how far back we should go—or how far we should move forward from where we are. My inclination is to dismiss such questions cavalierly—and to pin hopes squarely on the likelihood that closing up the realization loopholes will itself largely accomplish what is desirable, through its natural and logical effect on the attitudes of Treasury, Bureau, and administrative personnel generally. Present and past legislation and procedure has necessarily cultivated a "now-or-never," "grab-all-you-can" attitude among enforcement officers. It was that kind of system. If we had a law under which the Treasury could bide its time—could calmly let taxpayers overcharge here and there, circumvent realizations, futilely conduct tax-reorganizations to their hearts' content, and convert ordinary income into capital gains, confident always of a final, complete reckoning—there would perhaps be little occasion to worry much about reasonableness and flexibility in administrative practice. Field personnel could then focus on its proper and crucial task of ferreting out sheer dishonesty and of examining taxpayer accounting with reference to its integrity *over* the years. Their major concern should be, and under good law doubtless would be, with bases themselves rather than with annual basis-changes.

REALIZATION PROCEDURE: SPECIAL ASPECTS AND
SIMPLIFICATION POSSIBILITIES

SECTION 102

A whole section may be chopped bodily out of the law—with great relief to Treasury and courts and almost no effect on taxpayers save that of eliminating boundless uncertainty and some anxiety. Literally construed, the modest tax here imposed, on corporations "formed or availed of for the purpose" of avoiding surtax, applies to almost all profitable companies; actually, it applies, if at all, only to companies whose owners take off their surtaxes shamelessly, i.e., to avoidance exhibitionism. The main functions of this section are (1) to make the law seem impressively complex and unintelligible, (2) to let Congressmen think or say that they have, by incantation, really done something about a big problem, and (3) to encourage press editorials explaining to citizens that the alleged loophole, which that awful tax on undivided profits purports to narrow slightly, has in fact not

existed since 1921! What a blessing it would be to extirpate one of the most transparent hypocrisies which disfigure our statute. If not wholly useless now, it would become so under our scheme.

SECTIONS 500-511 (SUBCHAPTER A OF CHAPTER 2)

This, of course, is essentially Section 102, but intended actually to apply somewhere, and equipped with more than wrist-slapping rates. Its main effect is to make avoidance slightly more inconvenient. Under it surtax avoiders must either (a) use corporations with some "operating" income (over 20%) rather than mere investment companies, i.e., companies whose "operating front" is 20% or less, or (b) gang together in sufficiently numerous company so that no five avoiders (families) own more than 50% of the stock. In other words, this legislation puts a premium on large, and a penalty upon small, tax-avoidance investment trusts. For people who much prefer small investing companies (one family or a few "good" families), it commends acquisition of a small business "front" or just cluttering up an available operating corporation with investment-trust business. A dull tax-avoidance course is thus provided with a few water holes. *Rentiers* are compelled to get acquainted, businesswise if not socially, with other *rentiers* or, alternatively, to do their coupon-clipping in a very diluted atmosphere of profitable real business. Thus they see something of the business world; and the public sees nothing of scandalous avoidance, which is now discreetly veiled by a rather conventional investment-trust form or modestly consummated within what appear to be quite worthy commercial enterprises.

This subchapter reflects, besides almost impenetrable complexity, a sound intention or purpose which our procedure would fully achieve. Having prevented surtax avoidance, we would have no need for such minor but elaborately contrived harassing of avoiders. We could cut away the whole section, along with many other now commendable devices for diverting avoidance away from its more obvious channels and more scandalous manifestations. Imagine a statute and Regulations in which "undistributed subchapter A net income" never once appeared!

SECTIONS 331 TO 340 (SUPPLEMENT F)

This 1937 contribution to our rambling edifice attempts to deal, in impressively elaborate fashion, with a politically vulnerable avoidance device which 1936 legislation (and Subchapter A) had loudly "begged for." It seeks to discommode an avoidance practice which ceremonially converts realized taxable income into undistributed earnings of a *foreign* cor-

poration not fully subject to our tax jurisdiction; i.e., converts realized income into unrealized capital gain on foreign-corporation stock.

This Supplement roughly parallels Subchapter A, in its applicability—save that foreign “family” corporations, in order to be excluded, must have a business “front” of over 40%, instead of 20%. If the same five leading families own less than (the same) 50%, again the law does not apply. However, jurisdictional difficulties here *compelled* Congress to adopt a *sensible* procedure, namely, taxing the shareholders as partners, rather than taxing the corporation. Again, the range of application is narrowly and arbitrarily delimited. There is still only one little water hazard even on this foreign-corporation avoidance course. Congress doubtless feels the satisfaction of having solved a problem, at least in its Bermuda-company aspects. The solution, however, like that of Subchapter A, while admirable relatively in definition of applicability, is little more substantial than that of Section 102.

Supplement P lacks even nominal usefulness under our scheme. It too can go out completely and, presumably, without dissent⁹ and unbereaved. Again, imagine a statute or Regulations without a single cross-reference to “Supplement P net income”!

SECTION 28

Along with the above three chunks of statute, we may also cut away the section dealing with “Consent Dividends.” While not very long and not unintelligible, this section must disturb the laymen; and, in the Regulations, it involves a mass of cross-references and special applications which alone must approximate in length a good (if not a bad) doctoral dissertation.

Let us pause now for sober reflection on the sections which we have already vicariously excised, for they suggest one of the most powerful arguments for our proposals.

All these sections, bad as they are, are useful, defensible, and morally indispensable elements or adjuncts of our present income-tax procedure. Does anyone responsibly suggest that they are harmful to equity or to incentives? Is there any substantial, respectable support for their outright repeal? Yet does anyone believe that they more than surface-scratch the problem with which they purport to deal? Can anyone defend the irresponsible vagueness and calculated ambiguity of Section 102 (taxing an intention under an income tax!)?—or the location of the line separating taxable from nontaxable in either Subsection A or Supplement P?!

⁹ Unless that fool point about interest-saving is dragged in by some anti-vivisectionist.

There will be a few dissonant and dissident affirmatives in this antiphony, but not many. Now for the sixty-four-dollar question. Does any competent student believe that the annexing and superimposing of anti-avoidance gadgets will or can stop where we are now, if realization procedure remains essentially unaltered; and can he even vaguely discern where it will lead us or along what lines, in the long view? Where is stability in tax structure and procedure to be found, if we muddle along in this general direction? The so-called Second Basket of the 1938 Committee Bill was not buried very deeply; it will probably be unearthed and revived with strong support. If we can do no better, it should be enacted. It would disturb avoiders considerably and upset many avoidance schemes; but, after a time, it too would simply divert the avoidance stream without much affecting the dimensions—and leave the remaining loopholes differentially accessible in a way prejudicial both to equity and to enterprise.

All this is like trying to stop our national loss of good water to bad foreigners by damming up, somewhere in the Mississippi Delta, a small rivulet that happens to run right under a Congressman's nose. If the rivulet stinks, all right; but the project shouldn't be regarded as or called a conservation measure, whatever the precedents in agricultural legislation, even if it is extended to several rivulets.

There is, to repeat, no possibility of stopping where we are—unless people become utterly indifferent to unfairness or to wholesale avoidance. There is no good solution in the direction of recent measures but only slight diminution and endless diversion of the avoidance stream—and geometric growth of the tax-attorney population. We may continue to seek solution along the lines of Sections 102, 331 ff., and 500 ff. If these measures are good (and they are, in their context) broader application is certainly better. Few would favor application of Subchapter A to all corporations; yet none can really justify drawing the line between taxable (at 75%) and nontaxable (0%) where it is now drawn, or at any particular place short of universal application, i.e., a 75% tax on all undivided profits. Bad as this would be in other respects, it would not even solve the problem to which it was addressed; there would remain those gains of shareholders which reflect discrepancies, often enormous, between book values and market values of shares (both at purchase and at sale).

Continuing to build on present realization procedure, we can keep patching and "Supplementing" the statute until, in a generation, it reaches the size of an unabridged dictionary—and still barely keep even with the tax lawyers and their avoider-clients. So, to repeat, I seriously

commend study of these sections, especially Subchapter A and Supplement P, to those who find our proposals either radical or complicated. How shall we proceed from the tiny beginning there made? Or, starting with re-enactment of the 1936 tax on undivided profits, how might we refine and modify this crude gadget to make it serve its proper purpose? The answer, of course, is that we can never get far so long as we seek to correct inequities in the personal income tax, or to close its loopholes, by putting taxes *on corporations*, whether by the blunderbuss methods of an over-all tax on undivided profits, by the verbal ritual of Section 102, or by elegant, incisive measures which are of necessity ridiculously narrow and arbitrary in scope. As we have argued throughout, personal income taxes are good taxes; corporation income taxes are bad; and complicated admixtures of the two are, in principle and in practice, monstrosities. Present realization procedure in the personal tax, however, offers us choice only among such monstrosities.

REORGANIZATIONS, ETC.

It should be obvious that our procedure offers large opportunities for simplification of statutes, Regulations, and administrative practice with respect to corporate reorganizations and recapitalizations—and in the related cases of tax-free exchanges, involuntary conversions, etc., I am not competent to guide anyone through the maze which is present law and practice in this area; and I cannot confidently explain or describe many details of actual procedure. Consequently, what follows will be fragmentary and more general than specific. But first, a slight digression.

Much of the awful complexity in these phases of the statute and Regulations—and, I think, much of the obvious distress and confusion of judges trying to interpret them—arises out of an unpardonable mixing up of procedural rules for the personal and the corporation income taxes. Nowhere is abuse of the corporate fiction more glaring! Congress and Treasury have for years been trying to consolidate two utterly different kinds of levy and to lay down a single procedure (with, of course, the inevitable particularist separations on details) for the two of them. What a boon it would be if the Treasury would face squarely the question of what belongs in the one tax law, what in the other, and what in both!

Let us hereafter draft and enact a codification of our personal income tax as a complete, unitary statute. If we must have a corporation tax, let us afterwards and separately draft that part of the Revenue Act, incorporating (perhaps merely by cross reference) such paragraphs or sections of the personal-tax statute as may be useful. Let us then have separate

Regulations, the first to be integrated, complete, autonomous, and purged of irrelevant material. The Corporation Income Tax Regulations might then be published either with complete text or with its own material merely interlarded among references to the other document.

The real mess in tax law on reorganizations largely concerns the corporation tax. There are no very good answers to the questions and problems with which this mess seeks to deal. All corporation tax procedure is infested with or rested upon the fiction, elsewhere often useful, that corporations may properly be treated as or like natural persons. The fiction becomes obviously silly when these "persons" are merged, affiliated, or suddenly reincarnated in new adult forms, and the whole foundation or rationale of procedure (which was really never there at all) seems suddenly to drop away. One can't contrive reasonable rules or even plausible expedients in such cases. To ask what corporation income-tax procedure should do here, is to open up an awful question which delusions have concealed, namely: What is the corporation tax up to anyway? What, so to speak, is it fundamentally trying to do? Such questions totally demoralize discussion. Once raised, they indicate why the particular problems are hard: we simply don't know, no one knows, what the problems *are*. There can be no good answers to detailed problems within a bad or anomalous tax.

For personal taxation, there are no very hard and important detailed problems with respect to exchanges of property, whether corporations are involved or not. To be sure, we have "manufactured" such problems wholesale, with an anomalous realization procedure. Given that procedure, it is remarkable that present rules regarding realization from exchanges are as simple, and as generous to the taxpayer, as they actually are. Under good procedure, whether or not *any transaction* gave rise to taxable gain or loss would be of little real interest, save to that rare and invaluable member of society, the accountant-philosopher. The corollary or completing basis-adjustment would be always of the same order of importance, to both parties, as the recognition of a current-income effect (gain or loss).

We find here the real source of confusion and complexity with respect to exchanges, both of shares and of other assets. The Treasury has needlessly placed itself in a very awkward dilemma. It has accepted a realization procedure which, "accidents" apart, gives all the trumps to the taxpayer. He has full access to his accrued losses as deductions yet can deny the Treasury access to his accrued gains as taxable income. "Realization" is only the taxpayer's business. If he is poor, uningenious, or unfortunate as

an investor or enterpriser, he may have to expose his income in taxable form. In any case, the Treasury can only pray for realizations; the taxpayer takes the action.

Having slavishly accepted a bookkeeping rule which is heavily biased against both revenue and fairness, the government (Treasury) then faces the awful question of how far it shall go in taking advantage of the rule in special cases where the bias is accidentally mitigated. Narrow construction of the rule permits it to treat *any* exchange of property as "realization" of the property received, at fair appraised value. Shall it insist on the narrowest construction, or if not, how far shall that construction be relaxed? Narrow construction means inequity *among* avoiders. A relaxed rule means missing the chance to make relative taxes less unfair between the "exposed" persons and other taxpayers generally.

We need not consider here the many incidental anomalies and unfortunate consequences of a narrow rule—or the aggravation of its bad effects by Section 117. Instead, we merely suggest that these bad effects be attributed to the basic procedure—which interested parties appear to condemn as roundly where it narrows loopholes as they commend it where it opens holes. To such people, a fool rule is wonderful in "calling quits" at gift or death; yet it is scandalous to hit an involuntary conversion, an exchange of shares in ordinary reorganization, or a "horse-trade" of business properties for like properties. Whether it is scandalous when one sells low-basis securities to finance a long illness or to meet sudden, unanticipated bank demands, is not so clear!

Good procedure, of course, would give the taxpayer much freedom in using his "basis" in all property exchanges, subject only to accounting integrity and, perhaps, to injunction against obvious increase in the discrepancy between basis and current value. But, (laboring our point) the government can now concede such freedom only at grave risk (often certainty) of being *disinherited*. Remove this risk, and the whole business can be worked out with a few, brief, general rules, expressed in sentences whose subjects and predicates are ascertainable by almost anyone.

Note just one anomaly of detail which our procedure would remove. A "partially tax-free exchange" may now give rise to taxable income, to the extent of the money or "different property" received; but it may not give rise to a deductible loss. In the crazy-quilt of present procedure, this is a defensible asymmetry. It would not be defensible under our scheme. Incidentally, we could also easily be rid of fantastic procedural involvements where exchanges involve assumption of debts. (It is my inexpert

guess that Regulations 111¹⁰ here manage to put sense into illustrative examples which is lacking both in the text and in the statute.)

Under our procedure—to conclude these fragments—the taxpayer should have large freedom to handle all property exchanges much as he pleases, subject to accounting integrity and, possibly, to injunction against increased discrepancy between basis and value. Demonstration that the new basis is not obviously out of line with current value of the property to which it applies, should be a sufficient defense of any accounting the taxpayer may choose to follow.

DEPRECIATION AND OBSOLESCENCE

Our procedure certainly would permit, if not assure, simplification of rules and practices as to charges against wasting assets—how much, and at what critical points, only a professional tax-accountant or an experienced civil servant could adequately indicate. Here again, the problem is different as between individuals and corporations, since these legal creatures seldom die without “realizing” and, when merely transformed or reincarnated, usually pass on their “bases,” intact or properly adjusted, with their assets.

The Treasury and Bureau are notoriously tough about depreciation and obsolescence—so tough, I am told, that their own responsible officers in Washington, if not in the field, consistently amend and relax the published rules and regulations. The toughness, of course, is natural and rather inevitable, for reasons already labored above—a consequence of our procedure, not of native meanness among civil servants (although the procedure-environment much affects acquired characteristics). The Treasury, having misplaced itself in a kind of life-tenant status, naturally wants as little as possible of basis-depleting charges; while the taxpayer is aware that “you can’t take it [the basis] with you” or bequeath it either. The Treasury, while perhaps greedy and impatient under the best circumstances, must inevitably act a bit tough in the face of the danger of “double charging,” i.e., of having to concede large “bases” to estates and heirs for property already fully charged off. Under our scheme, however, it could rest easy, save as regards accounting integrity.

One must be deeply impressed by responsible reports of administrative arbitrariness and unreasonableness—but also by a certain unreasonableness in complaints which fail to recognize that the fault is really in the

¹⁰ Professor Simons' original reference was to Regulations 103. For the convenience of the reader, however, all references to Regulations 103 throughout these excerpts have been translated to Regulations 111. [Ed.]

law. It's hard to be sportsmanlike in a money game where the rules give your opponent the aces and the best coaching too. One of the great merits of our scheme is that it would enable revenue officers to behave like gentlemen, save when looking for fraud, and to advise taxpayers much as would their own hired experts. It might, incidentally, be a great boon to accounting practice and professional insight. Imagine a community full of civil servants who could and would advise taxpayers *against* accumulating secret reserves, and quite disinterestedly!

The present problem focuses upon obsolescence, largely because of a rather empty distinction which the Treasury has appropriated from accounting. Depreciation, by somewhat esoteric definition, is something that follows conventional, though not impressively statistical, norms of "experience." When these norms work badly in a particular case, we have on one side an obsolescence problem. The actual norms, being largely the contrivance of auditors anxious to assure *adequate minimal* (rather than *maximum reasonable*) charges, probably serve the Treasury rather too well—and overload the obsolescence Bureaucrat.

Nothing in accounting is much more provisional and conjectural than an obsolescence charge. If not pure guessing, it is a kind of estimate which must be treated as tentative, subject to radical revision, and highly experimental. If one is both wise and lucky, one may do fairly well over the years. But the Treasury, faced with disinheritance, cannot be very tolerant of generous experimental charges.¹¹ Trying to prevent overcharging of such conjectural items, it naturally enforces undercharging in many cases if not on the average (and who cares about averages in personal taxation?!). Under our scheme, the Treasury could afford to take its chances with generous charges and, I think, actually would do so. There is no good solution under present procedure for an admittedly serious present difficulty. The procedural change should, at the least, yield a shift of the enforcement eye from "minimal adequate" to "maximum reasonable"—which is perhaps as much as anyone would ask.

Some present rules, if not bad now, would surely become indefensible under our scheme. At present, the "basis" of depreciable property must not exceed the cost less something which won't fit into a sentence, namely, the sum of the following items separately determined for each year:

¹¹ Cautious niggardliness finds less excuse with respect to corporations—although there is now a nasty problem here, with both tax rates and business uncertainties at a wartime peak. In principle, however, there is a derivative problem, not of major importance, in the effects of corporate accounting on the personal tax. Thus, higher corporate charges may mean not only smaller dividends but larger "distributions out of capital" which, in turn, reduce shareholders' bases instead of increasing their incomes; and a basis-change may never have its income effect.

amounts allowed (actually charged) or amounts *allowable* (the maximum permitted?), whichever is greater. Thus, if you charge \$1,000 in a year when \$2,000 is permissible, your basis falls by \$2,000; if you charge \$2,000 (permitted) in another year when \$1,000 is permissible, again it costs you \$2,000 in reduced basis! "A taxpayer is not permitted to take advantage (*sic*) in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts (*sic*) in prior years."¹² In other words, one cannot offset one year's overguess against another's underguess, on the standard of a Treasury which knows *all* the "facts"—and perhaps, like Mr. Thurber's lonely figure, only facts.

One finds here a really useful by-product of the distinction between depreciation and obsolescence. At any rate, my casual acquaintance with the Regulations has revealed no corresponding "basis rules" about obsolescence, although the short paragraph devoted to obsolescence charges contains intimations of omniscience.¹³

Our procedure should sublimate all this loose talk about annual depreciation or obsolescence as *fact*. It should also, by virtue of averaging devices, do something to mitigate the stupid adherence by the Treasury to an accounting rule which, while properly enforceable for other purposes, does not belong in an income tax—namely, that depreciation charges must persist relentlessly through years of no income and net loss. Here is one little opening for taxpayer averaging; and the Treasury, perhaps angry at some "crank" who has been deploring its sins of omission, slams the door tight against it. All I can see in this regulation is Treasury determination to exact every last penny of overtaxings from persons with fluctuating incomes, and to show enterprising upstarts the merits of being a club-loving *rentier* or a respectable bureaucrat. In a word, I don't like it.

DEPLETION

There is little occasion here for discussion of depletion. All that is sequential and relevant, of what we are competent to say, has been said above. But the subject is far too engaging to pass over when an opportunity offers for digression.

Our topic here is the personal income tax *qua* pork-barrel. Attention should be called to the fact that income-tax Hearings now closely resemble my impression of Hearings in the Subcommittees on Rivers and Harbors and Pensions or, more notorious of late, those on silver policy or margarine taxes. After Ways and Means has listened to the life-insurance

¹² Reg. III, § 29.23(1)-5 (1946).

¹³ Reg. III, § 29.23(1)-6 (1946).

lobby, to the oil, gas, and mining company executives, to Mayor La Guardia, Elisha Friedman, Harley Lutz, and other ardent proponents of "tax-exempts," there is little time left to write the new income tax, and less reason for calling what is written by that name.

The trouble here arises largely from the corporation tax which, being unprincipled and unreasonable at best, is defenselessly exposed to "reasonable" modification on behalf of anyone with a claque. But the personal income tax isn't faring well either. It reads less and less like a prescription of taxes on persons according to their incomes, and more and more like an inventory of miscellaneous dispensations to groups regularly participating in the Hearings.¹⁴ This is a serious matter for anyone who dislikes in rem elements in an income tax, even if he sees no suicidal danger in concealed democratic corruption. Depletion is only a case in point.

The depletion loophole dates from an early dispensation known as "discovery value." Legend has it that this was originally a ransom paid by Congress to a gang of prospectors, drillers, and option-hawkers who rode right into the Capitol and threatened to shoot the place up if the ransom was not paid. The legislation thus attained was explained to Joe Doak as a means for advancing geology. In any case, a large breach was made in that minimal requisite of fair income taxation, namely, in accounting integrity as to "bases."

If Mr. Rockefeller (or, by chance, someone else) "discovered" oil, his income-tax basis of the property in question, instead of being its cost, became alternatively the value "at discovery or within thirty days thereafter." In other words, any accidental increase in land value because of oil discovery was not income to the drilling owner or option-holder (merely tax-free reward for a good deed) if he sold the property, and could be deducted as depletion from his income if he operated the well. This legislation, a kind of subtle memorializing of the covered wagon, is reputed actually to have benefited slightly one real flesh-and-blood prospector; and there are several known instances where it benefited shareholders of companies with less than \$100 millions of capital.

¹⁴ This trend has many unfortunate aspects besides those stressed in the text. It means cluttering up the statute with innumerable exceptions to general rules, if not, for corporations, jamming together quite different kinds of taxes on enterprises in different fields. More important, it means writing into the statute reams of stuff which should be, if anywhere, only in Treasury Regulations. Congress cannot stick to or perform its proper job of laying down general rules of income-tax procedure. It must also write in masses of administrative detail, because it is precisely in such details that handouts may most effectively and most obscurely be dispensed. Thus we move further and further from a principled statute and toward the mess which was the French Income Tax, if not ultimately back toward graduation by outlays for wig-powder, servants, and carriages, or by doors and windows. Something awful must happen to income taxation before the statute comes to require its own sturdy table.

The section in question, however, gave rise to difficulties. It was a bit hard to exclude hindsight in appraisals or to get anyone to accept a determination of discovery value which promised less than 50% depletion charges¹⁵ against future "net" income. And there was always the hard question of how long the oil or ore would last. Besides, there were lots of corporations, with profitable use for gratuitous depletion deductions, which either had no plausible claim to rank with Columbus or had found the Treasury and the courts unimpressed by their pretensions. Thus, it was proposed to abandon discovery value for the politically important industries and, while depriving no big company of its real benefits, to make them dependent merely on the *property's having been discovered* (and what property hasn't been?), so that they followed the property itself rather than the prospector.

So, depletion procedure was marvelously simplified. If only all hard procedural problems could be solved so neatly! One no longer needs a geologist to determine depletion; one needs no *relevant* facts at all; and, naturally enough, all that silly fuss about basis adjustment is largely a thing of the past. One has little more tax use for bases than for geologists. If you keep your accounts in accordance with the law, your bookkeeper may rush in some fine morning and anxiously inquire what account he shall credit for the amounts charged as depletion; if he keeps on crediting Reserve for Depletion, that account will exceed the property account to which it relates! He may be bewildered or unsettled professionally when you tell him to keep right on charging and to make the credits to Surplus; but that is what you must tell him. He has probably heard of direct transfers to Surplus, but chances are he never imagined one quite like this!

Depletion for oil and gas properties is now simply 27½% of gross income; for sulphur mines (both corporations!), 23%; for metal mines, 15%;¹⁶ and for coal mines, 5%—but not to exceed 50% of the net income

¹⁵ The maximum percentage permitted "out of" discovery value.

¹⁶ A few less important cases should be added for completeness: fluorspar; ball and sagger clay; rock asphalt.

While writing this section, I providentially received a seemingly excellent "Street" document analyzing the investment outlook for oil stocks. Its cold, objective tax-forecast speaks eloquently to my present point. Here it is:

"There is no danger whatever in the present depletion allowance of 27½% on crude oil being lowered. Reasons: The powerful silver bloc in Congress plus the other mining states congressmen, together with the unorganized but formidable oil bloc, have the votes to veto any changes in depletion allowances. The allowances are not uniform, oil being the highest, but these interests don't want them tampered with at all; they want the policy to remain as is. You may expect Mr. Morgenthau, and perhaps Mr. Roosevelt, to trot out their demands again that these allowances be lowered or repealed, branding them as unfair and inequitable, but they won't even get as far as they have in other years."

before depletion. Companies which prefer an old-fashioned method, as for depreciation, may use it if they prefer (as few do!)—take your choice. Mining companies not eligible for percentage depletion still have the discovery-value option, if they can successfully claim discovery—and most of them can to some extent if they just keep on digging!¹⁷

Now I don't like special subsidies (and, of course, no other kind makes sense—we can't very well all pay subsidies uniformly to one another and remain sane). But open, straightforward ones, paid directly from the Treasury and formally recorded in public documents, have relative merit. They are less likely to survive out in the sun. It's this trick of hiding subsidies away where only a few experts can see or detect them that jeopardizes democracy and makes me mad. Hiding them in tax laws is peculiarly bad. I used to think the exemption of interest on bonds of Joint-Stock Land Banks was close to some absolute nadir in policy. But percentage depletion puts that fool exemption out of the running—and, besides, is quantitatively important.

It is a shame that the Treasury does not publicize the facts in such cases. I can only report here a rumor among statisticians that the total of depletion charges in the oil business greatly exceeds total private capitalizable outlays for prospecting, exploring, and developmental research. Indeed, there is strong suspicion that *what the Treasury loses in tax revenue* by virtue of fictitious depletion charges (i.e., from the excess of charges over what they would be without handouts to this special class of property) exceeds all those private outlays. I can't vouch for these conjectures—although the rough orders of magnitude seem plausible. Certainly they suggest an interesting commentary on the apology that this racket serves to promote discovery and exploratory work—which apology, along with that for tariffs on oil products, is also strangely discordant amidst wider clamor about national oil conservation! But the fact that I don't know the facts—that only beneficiaries of the subsidy know the orders of magnitude—is an adequate reason for griping about the subsidy form.

Another proper complaint is that even a specialist cannot make out what the law is, by however many rereadings. It becomes clear, after strenuous efforts, that a corporation may have one basis (or none at all) for its annual charges; it may have a very different basis for determining when distributions to shareholders are "paid out of capital"; and what the

¹⁷ If your vein turns out to be far larger than anticipated, that is not a "discovery" if the vein is uninterrupted; and your discovery-value or other "basis" remains unaltered. However, if you can manage to dig through a few feet of "interruption" before becoming aware of the unexpected largesse of nature, then your "basis" is generously and gratuitously replenished and your tax outlook radically improved! The moral, I suppose, is clear: stick to the precious and semi-precious metals.

general rule is for gain-or-loss basis when property is sold I defy *anyone* to determine. A hyperspecialist might tell us the *practice*.

My ignorance (perhaps unpardonable) makes it difficult to discuss a matter of central interest: namely, the question of how one determines gain or loss at sale of a property which has been written off completely by (allowed) depletion charges—or written off twice or ten times over! The actual rule is fairly clear for years preceding 1932. You computed your gain-or-loss as it would have been computed if you had followed honest, conventional accounting throughout—i.e., in terms of cost of the property less what ordinary, honest charges would have been made with approval of a C.P.A., and without regard for what you did actually charge off under the dishonest law. This, of course, meant eating your cake and later eating most of it all over again. What corresponding procedure has been since 1932, I can't pretend to know. The rules seem to be the same for depletion as for depreciation and obsolescence; but, if so, I am fascinated by the business of determining gain or loss from a negative basis. Possibly *practice* simply calls quits at zero. But the law says adjustment shall be made in *all* cases for "depletion, *to the extent allowed*"! This is a bit like the legendary Arkansas statute about right-of-way at railroad intersections.¹⁸

The actual problems here are mainly those of the corporation tax; but they are not insignificant, either now or under our procedure, for personal taxation. Consider the case of an unincorporated oil, gas, or mining enterprise. Our procedure calls for giving taxpayers wide latitude in the use of their bases (cost or value at transfer, adjusted), subject always to accounting integrity as to bases. What shall our procedure do about depletion? Clearly one can't give much freedom in the use of bases if there are cases where taxpayers have no bases (percentage depletion) and/or no accounting integrity (discovery value). If the mess is rotten now, it would be insupportable within our scheme. Don't ask me what should be done about negative bases! There is nothing else to do about them, under good law, but to lock up the taxpayer! One may calculate his annual charges as one pleases: as percentage depletion or as amortization of discovery value. But when a person has exhausted his actual basis as determined by hon-

¹⁸ My *guess* is that the Bureau does call quits at zero—which reasonable people might condone as the least unlawful among feasible or practical rules. If so, I am unreasonable. My view is that, if a depletion racket is legitimized under Section 114, it is not a proper action of the Bureau to extend it by administrative amendment of the plain language of Section 113, even though such amendment does facilitate "orderly alienations of depletable assets." It is not the business of the Bureau to anticipate the Silver Senators et al., i. e., to change legislation because they would soon change it if the Bureau didn't. If we must have the depletion racket also in Section 113, Congress should publicly put and exhibit it there. The Treasury should not ransom the Secretary privately by administrative regulations.

est financial accounting, he can make no more charges unless he replenishes his basis either by investment *or* by writing it up at the expense of equal simultaneous addition to his taxable income. Under our scheme, those who want subsidies will have to go to the Appropriations Committee. Corporations can deplete as they please for corporation tax for there would not be any such tax. But individuals in the same income circumstances must pay the same income tax, including even those who mine silver.

Consider now calmly how *many* pages might be cut out of statutes and Regulations if only we treated owners of depletable assets like other taxpayers, instead of like monsters who might eat up the Secretary if the huge ransom payments were discontinued.

BAD DEBTS AND WORTHLESS SECURITIES

These cases are more important than their quantitative magnitude would suggest. They involve special difficulties for both Bureau and taxpayer and are of much interest in principle. Like depreciation, depletion, obsolescence, inventories, and involuntary conversions, they invite concessions from the realization criterion by the Treasury in favor of the taxpayer.

Being allowed to reach accrued appreciation of a taxpayer's assets only if or as he sells, the Treasury is naturally reluctant to permit loss deductions on more generous terms. Charges against wasting assets are, in principle, a concession, albeit a conventional one, from the realization rule. This view perhaps suggests a rational explanation, both of the niggardly restriction of actual charges and of the narrow limitation of the category of chargeable assets. What, now, of other assets?

Present practice appears to distinguish, *inter alia*, among three categories: (1) commercial accounts-receivable, where a kind of market-value inventory-procedure is permitted (bad-debt allowances); (2) fixed money contracts, where, subject to onerous burden of proof, the asset not only may be written off when worthless but may occasionally be written off partially; and (3) ordinary equities (corporate stocks and other), where only total loss is recognizable. While defensible under present procedure, such categorical distinctions among kinds and degrees of loss are certainly inelegant and troublesome. They would be indefensible under our scheme.

The crudity of the realization criterion, strictly construed, is evident in the case of property become worthless. Here we find something roughly analogous to the vanishing of accrued gains at gift or death. The asset has simply died; and the taxpayer is shut off from the normal device for "real-

izing" a loss. It is hard to arrange a sale of something worthless, especially if the junk-man will have none of it; and hard, in any case, to demonstrate that the transaction was not a gift! If you can get someone to haul the thing far enough away, the Treasury will let you deduct the loss; but this on principle is a concession from the rule (of which concession gain-realization at gift or death would afford a kind of counterpart).

Depreciation of "non-depreciable" assets also presents an awful problem of income allocation among periods. Not being authorized to give away government property, the Treasury naturally wastes a lot of its and taxpayers' time seeking to assure that taxpayers do not "unlawfully" allocate losses to periods where they are useful (where the marginal tax-rate is high) instead of to periods in which they "actually occurred." Again, this means deliberate aggravation of penalties on mere fluctuation of annual income—and litigation which is even worse in kind than in amount. It is the antithesis of taxpayer freedom in the use of their bases. A balanced, integrated realization procedure and some kind of averaging are indispensable, if only to preclude bitter controversy over the essentially metaphysical "questions of fact" here involved, and to put an end to preposterous legal ceremonies, reminiscent of trials for heresy or witchcraft, for "settling" such questions.

Under our procedure, all this knotty mess could easily be untied. With full recognition of gains assured there would be no excuse for niggardliness, as to kind or degree, with respect to losses recognized. Everyone could be not only permitted to keep his bases close to the value facts as currently apprehended but actually encouraged to do so. Securities could be written down just as readily for value declines of 10% or 99% as for total loss. Instead of being obliged to demonstrate that "due . . . to the financial condition of the debtor, *or conditions other than market fluctuation*, the taxpayer will recover upon maturity none or only a part of the debt evidenced by the bonds,"¹⁹ the taxpayer need justify his write-off, if at all, *only* on market evidence. The great improvement, of course, would come in the case of equity securities where unquestionable market evidence of even radical depreciation is now inadmissible and irrelevant. Instead of forever saying that shareholders and others cannot claim losses "merely on account of shrinkage in value . . . through fluctuation (*sic*) of the market,"²⁰ "our" Regulations should say: "The taxpayer is strongly advised, at least in the case of all assets such as listed or actively traded securities, to keep his basis reasonably in line with current values and,

¹⁹ Reg. III, § 29.23(k)-4 (1946) (italics added).

²⁰ Reg. III, § 29.23(e)-4 (1946).

erratic market fluctuations apart, not to allow gross discrepancies between his basis and his probable realization to arise or to persist."²¹

INVENTORIES

Since inventory procedure is largely confined to assets of high turnover, present realization procedure (Lifo apart) involves fewer glaring tax anomalies here than in its other aspects. Actual rules of tax procedure, however, are inordinately complicated, confining, and inflexible.

The Regulations contemplate, in the ordinary case, that inventories will be valued, as per Fifo, at cost, or at cost or market whichever is lower. Inventories at market, e.g., for raw materials, are left in an ambiguous position, being neither explicitly permitted (save for dealers in securities) nor excluded. The "farm-price method" and perhaps the "retail method" involve an approximation to market valuation, but for restricted special cases and, of course, for only "finished goods" in those cases.²²

The cost-or-market rule is significant again as a concession by the Treasury from a strict realization criterion. In its asymmetry, it is obviously biased against the Treasury, since it permits deduction of unrealized losses while not permitting or requiring the corresponding recognition of accrued gains. It is perhaps the most important case, after charges for wasting assets, of loss deductions permitted without realization. Its importance in principle should not be lost sight of merely because it involves such a natural adjustment of tax procedure to established accounting practice. If tax law grants this concession where conventions of accounting appear to make imperative demand, accounting should not begrudge tax law the constructive realizations which the latter imperatively requires, especially since no untoward influence on business or accounting practices is involved in such a reciprocal concession.

Introduction of these constructive, personal realizations at gift or death would permit a vast simplification and a much needed loosening up of inventory rules. As things stand, the taxpayer is confronted by a range of options which, while numerous, are far from being adequately inclusive, and of which each is unduly circumscribed. Moreover, having made his choice, the taxpayer is severely restricted as to changes of procedure and as to required transition adjustments where petitions for change are approved. All this rigidity of detail could and should be broken down under our scheme. With final reconciliations assured for all taxpayer individ-

²¹ Reg. 10,000, § 29.23—we won't need subsections!

²² Thus, for none of the really appropriate or important cases and for one of the least appropriate cases (retailing).

uals, inventory procedure might be circumscribed only by the requirement of accounting integrity through time. The taxpayer might at least be permitted any inventory valuation which does not involve an increased discrepancy, from the preceding year, between the inventory figure and the facts (i.e., market or fair-appraised value).

Some accountants will deplore the wide latitude or taxpayer freedom in inventory valuation which our scheme offers or permits—as likely to encourage “loose or radical tendencies” in general accounting practice. Such people will perhaps also be alarmed by our narrower proposal which seems to use current market valuation as a kind of norm or criterion for limiting taxpayer discretion. Even on their premises, however, what we here have in mind seems rather unobjectionable. Taxpayers might be given much the choices now open to them (although current-market valuation certainly should be available, at least in clearly appropriate cases, as one definite option), with no questions raised so long as they adhere to the acceptable procedure chosen. Our current-market criterion would thus enter only as part of a clear-cut rule determining when changes of procedure could be made *without approval of the Commissioner*. This would reduce the scope of power vested in the Commissioner and avoid the necessity, in most cases, for seeking and obtaining special dispensation for change of method. Thus taxpayers could freely change from one inventory method to another, subject only to the necessity of asserting, with appropriate declaration of facts, that the change would not serve to reduce current taxable income by increasing unrealized inventory gains (over those of the preceding period and/or over what such unrealized gains would have amounted to in the current year under the procedure abandoned). What constitutes proper and improper accounting for nontax purposes, or what changes are acceptable and unacceptable, might then be dealt with as nontax issues, and on their merits as such. As elsewhere, the Treasury would have little real concern about the details of inventory adjustments.

The idiosyncrasies of Fifo’s odd younger brother, Lifo, cannot be closely examined here. This recent addition to our menagerie of tax curiosa, however, could clearly be “put away” under our scheme, with considerable statute simplification and perhaps with some reduction in insanity among conscientious accountants. The tolerance or silence of reputable practitioners with respect to this tax-induced corruption of professional standards is sometimes amazing to the outsider. Having railed against proposed departures in tax law from time-honored rules-of-thumb in respectable practice, the professionals seem now amazingly undisturbed about a rank departure calculated to reduce particular tax liabilities.

Last-in-first-out procedure (Lifo) really grants to taxpayers the privilege of using a method explicitly and properly denied to them under the Regulations,²³ namely, "Using a constant price or nominal value. . . ." This procedure, besides misrepresenting current income, raises in the imagination of one not wholly initiated into a mystery the strange spectacle of an honest C.P.A. solemnly certifying to a balance sheet for 1933 where inventories are valued at 1929 prices—or, prospectively, certifying to a balance sheet in 1999 where the inventories are valued at cost in 1939. I have never found much intellectual satisfaction in original-cost schemes of public-utility valuation for rate-making purposes. Even if this latter idea has merit, however, it hardly can retain that merit intact when extended to *original, historical* cost in tax-procedure inventories. Within a century or two, some inventory figures in current-income declarations are certain to become interesting to archeologists! One might then do scholarly research in the remote history of prices merely by acquiring access to recent income-tax returns!

The explanation of all this foolishness appears to lie in the general aversion to explicit averaging. The only sound argument I have heard for the Lifo option is that it would, on recent data, serve to mitigate a serious overtaxing of corporations subject to wide income fluctuations. Thus we have dragged in all this mess through the back door because we were unprepared to admit averaging rebates undisguised at the publicly exposed front entrance! To what lengths of accounting dishonesty and statute complications we have gone merely to disguise an urgently needed reform—and what limited and special relief we have thereby attained for a pervasive injustice and diseconomy! If Lifo is not the most complicated of averaging schemes, and the least effective, my judgment on tax issues (as many readers will perhaps readily agree) is worthless. Any crude scheme of averaging rebates, not to mention flexibility in inventory procedure, would enable us to get rid of an unlovely contribution of uninspired statistical empiricists to our tax edifice.

To be sure, a case can be made for Lifo, the rest of our tax law being what it is.²⁴ Broadly viewed, this case is less a defense of Lifo than a satire on the rest of the law. The expedient, moreover, indicates alarmingly the route ahead if we continue such ad hoc tinkering and keep on trying to get a satisfactory tax edifice by forever adding gadgets and superstructure instead of repairing the foundation.

²³ Reg. III, § 29.22(c)-2 (1946).

²⁴ It is interesting, incidentally, that the Lifo option is available only to taxpayers willing to abandon the privilege of writing down inventories to "market," when current market values are below cost.

STOCK DIVIDENDS

The stock-dividend problem, while essentially unimportant, invites special attention. It has been the subject of extensive, conspicuous litigation, and of ponderous judicial rhetoric which achieve hitherto unplumbed depths of legalistic foolishness. It has produced a mountainous collection of journal articles and commentaries, some of them burdened with immensely irrelevant scholarship, legal and economic. Economists, blissfully ignorant of elementary bookkeeping, have risen in hordes to pronounce upon the relevant accounting problems. Accountants, blissfully ignorant of elementary economics, have rushed in to clarify the economic problems. Others, mainly lawyers (save for Professor Fisher), have, as misguided and unwitting Platonists, sought to uncover the realities and to dispose of all problems by ad hoc revision of dictionaries. Amidst all this verbal barrage, the stock-dividend problem has come through almost untouched. Great intellectual excitement has caused people to search furiously for the problem, and often to "find" it, almost everywhere save where it plainly and obtrusively was.²⁵

The problem of income tax procedure as to stock dividends can usefully be discussed only as a detailed aspect of larger problems. A really good solution is attainable only by radical change in present procedures for determining the taxable income of (inter alios) stockholders in corporate enterprises. Proximately the problem is one of undistributed corporate earnings and, especially, of gains and losses on capital assets; at bottom, it is a problem of the present avoidance loopholes at gift and death.

Transactions between a corporation and its shareholders as such should give rise, accounting-wise, either to taxable income to shareholders or to change in the gain-or-loss basis of the stock in the hands of shareholders when the transaction occurs—or to both. Whether any particular transaction is treated as giving rise to personal income or to change of basis must be determined rather arbitrarily. Arbitrariness, however, need not result in unfairness among taxpayers if ultimate reconciliation is assured—save for needless absence of averaging correction of excessive levies where taxable annual income fluctuates widely. At best, the arbitrary procedure would be only provisional, treating a particular receipt as income or not income subject to a definitive reconciliation in the future. Arbitrary details may comprise a total procedure which, over time, is not arbitrary at all but nicely calculated to apportion taxes among persons according to their real income circumstances.

²⁵ At the cost of some (perhaps useful) repetition, I am following in the next few pages the language of a memorandum prepared against the possibility of a more radical decision than that actually rendered in *Helvering v. Griffiths*, 318 U.S. 371 (1943).

We should always recognize that the best procedure must be crude and rough in its determination of a person's relative income as among particular periods or years. Even if this were not true, the case against taxing persons progressively according to annual incomes would still be decisive. Tax payments should be provisional in any case. Since income is inherently a provisional estimate, the case for averaging devices or rebates is doubly clear.

Income tax procedure should seek to minimize fluctuations in the taxpayer's annual income, *besides* correcting for it afterwards. A more elementary objective, however, is that of following through with any procedure so that all positive elements of income are ultimately reached and all negative items fully deducted—i.e., so that all gains and losses accruing to a person during his lifetime become taxable to or deductible by *him*. Fluctuations of annual income may be dealt with afterwards. It is failure to reach income or to permit adequate loss deductions which must primarily concern the student of policy.

A basic fault of present procedure is that it fails so to follow through—that it provides for no such final or ultimate adjustment or reconciliation of initially arbitrary determinations. The result is that the greatest importance attaches to details which should be unimportant. Under good procedure, it would be a matter of small moment whether a given event or transaction gave rise to taxable current income or to equivalent change in the basis from which taxable income will, on some future occasion (certainly sometime), be calculated. As the law stands, an inherently arbitrary choice determines, in many cases, not merely *when* an element of personal income shall be taxed but *whether* it will ever be taxable at all—for the change of basis is now without effect if the property remains in the possession of the taxpayer or his donee until death. At best, the choice determines whether the element of income will be fully taxed or very partially taxed as capital gain. On the other hand, the same kind of arbitrariness in detail may now grossly overtax an individual while offering him a potential loss deduction which, because of Section 117, is nowise equivalent or compensating.

It would not be wholly unreasonable to treat all payments to shareholders as returns of capital (as reducing their basis), until the basis was exhausted—as we used to do for life annuities—if then all subsequent receipts from the shares (sale proceeds, if sold, or *the value at time of gift or death*) were treated as net income. Conversely we might treat all receipts as net income when received, postponing reconciliation until sale, gift, or death—i.e., always leave the basis unchanged until the property passes to others, but with full reconciliation at that time.

Actual procedure approximates the latter of these extreme devices, but with many exceptions: payments from depletion reserves and other returns of capital; distributions out of pre-1913 corporate earnings; investment-company dividends offset by net capital losses; etc. In general, present procedure presumes that anything "paid out of" accumulated corporate earnings is income to the shareholder. The arbitrariness of this presumption, where shareholders have acquired stock at widely different times and costs, is evident, especially where one has purchased shortly before declaration of a large and wholly extraordinary dividend. What calls for emphasis is, not that this rule is wrong (it is perhaps the least objectionable among feasible rules), but that it involves a *presumption* and is defensible only if it is really provisional or tentative, i.e., subject to ultimate correction or offsetting in the future.

The question of whether a stock dividend *is* income should never have been asked. The proper question is whether treating it as income is *provisionally appropriate* as part of a total system of procedure; and the answer must run in terms of how the total system works out in allocating income among periods and, especially, how properly it measures the aggregate income over the taxpayer's period of ownership. For a good total system, the question is trivial or of very minor importance. Under present law, the particular question is hard or impossible, since no really good result is attainable by possible change in procedure merely as to dividend transactions.

Let us note here several possible procedures:

1. Stock dividends (common-on-common) might be treated as taxable income,
 - a. At fair, appraised current market value, or
 - b. At par or other value as used by the corporation for its balance-sheet accounting.

In either case, the basis for the old shares remains unchanged; dividend shares might be handled either as per "Lifo" or "Fifo."

2. Dividend shares might be treated merely as having zero basis or "cost," the basis of old shares remaining unchanged—again with "Lifo" or "Fifo" for the dividend shares.²⁶

3. The cost or "basis" of the original shares might simply be apportioned over the original and dividend shares, the basis of dividend shares becoming the average cost of new and old shares where old shares were purchased at different prices, with equivalent reduction of old-shares bases. Here there could be, besides "Lifo" and "Fifo," allocation of new shares pro-rata among increments of original shares, and even allocation

²⁶ *Helvering v. Gowran*, 302 U.S. 238 (1937).

of a different basis to new shares received on each increment (certificate) of old shares (which, I understand, is the present practice—the Regulations seem to involve calculated ambiguity on the question).

If all transfers of property were treated as “realizations” of the fair market value at time of transfer (by donors at time of gift and by decedents during their last taxable period, as well as by sellers), it would obviously make little difference which of the above procedures was followed. Save for administrative complications, taxpayers might be allowed to choose freely among them. *Now*, however, procedure (1) would assure full taxation of gains which might otherwise escape entirely or which might, as capital gains, be taxed to only half their amount and at a lower rate. For shareholders with accrued losses, it (1) would add an item of current income, while increasing the realizable loss deductions. Some taxpayers might die without realizing the offsetting loss; but, at best, the added loss, if realized, would reduce taxable income by only half the amount by which the dividend increased it—not to mention the other limitations of Section 117.

It is my opinion that the Treasury should not seek radically to alter present rules as to stock dividends even if Supreme Court decisions should clearly render such alteration possible. There is no hope of making any real headway against basic shortcomings of the present law by such alterations; and, with a few exceptions, considerations of simplicity in procedure dictate adhering to the “legislation” effected by the Court in the *Macomber* and subsequent cases. *Qua* legislature, the Court has not done badly, although its reasoning has been almost wholly misguided, and its dicta sometimes ridiculous. If the Court should henceforth leave such legislative matters to the Congress—judging procedure as a whole and its results over time rather than ad hoc details—recommendations for legislation might be made as follows:²⁷

1. Dividends of ordinary common stock in such common stock should give rise merely to change in the per share basis. If legally feasible, it might be desirable, where the original shares were acquired at different prices, to allocate the basis on the assumption that all shares were purchased at the cost of the earliest lot (or, better, the cheapest lot)—and to apply the “Lifo” rule to dividend shares or, under “Fifo,” to treat them as part of the earliest lot of original shares. In any case, procedure in such cases should be clarified in the Regulations, if not in the law. (I find Regulations 111 ambiguous or unintelligible on such questions.)

²⁷ The following are proposals for detailed changes *within* the present faulty procedure as to realization.

2. All other "stock" dividends should be fully taxable, at the market value of the dividend shares—preferred-on-common, common-on-preferred, etc. This involves some change from present law, especially in special cases of dividends, preferred-on-common. The rule here should be general and simple, and all complicating exceptions, based on exegesis of the *Macomber* decision, should be eliminated.

Simplicity (and narrowing of loopholes) dictates leaving the basis of the old shares unchanged and using a market-value basis for the different dividend shares received—i.e., following here the analogy or presumption of the cash dividend.

3. In the interest of simplicity and convenience, there should be radical change in procedure as to stock rights. Where rights are exercised by the shareholder, policy may be debatable. My preference is for giving the new shares as basis their actual present cost to the purchaser—i.e., option price if rights are exercised by original shareholder and option price *plus* cost of rights where rights are purchased—and, save where rights are purchased, for imposing the "Lifo" rule on stock acquired by means of rights.

However, where rights are sold, the selling value should be treated as net income and no change should be made in the basis of the shares. The *Miles* case²⁸ introduced needless complications, especially for the small shareholder. Surely few if any small shareholders, selling their fractional rights, do or could follow the lawful procedure. It would be a great simplification to treat the proceeds of all right-sales as income—and one of the important changes opened up by reversal of the *Macomber* decision.

To repeat, I think procedure should be simplified also in the case where the stockholder exercises the rights (as above)—that the basis should be actual, not apportioned, cost; that future sales be treated as made, first, from rights-purchased shares; and that the basis of old shares should remain unchanged by exercise of rights.

4. The seller of rights should, at least, be *permitted* and encouraged to treat the proceeds as current net income, if he so chooses, and to retain the old basis for his shares. A corresponding option should also be available to the person who sells promptly any dividend shares (common-on-common).

I am aware that my suggestions as to rights and rights-acquired shares do not square neatly with the suggestions as to the common-on-common dividend. Consistency in inherently arbitrary details, however, is not a great virtue. What I'm after is simplicity—i.e., a set of rules such that, in the great majority of cases, a taxpayer, computing gains or losses from

²⁸ *Miles v. Safe Deposit & Trust Co.*, 259 U.S. 247 (1922).

sales, will need to determine only the actual cost of the shares sold. Indeed, I might go still further, proposing that the common-on-common dividend be treated as net income where fractions of shares are sold. This would simplify arithmetic calculations and, what is more important, would require no change of basis for innumerable holders of small lots who promptly dispose of their fractional shares.

It may seem strange that, going so far, I do not simply go on, proposing to treat all dividend shares as income when received. This solution would be elegant and would avoid many complications and seemingly arbitrary distinctions. The probable consequence is that there would be no more common-on-common dividends—a result not greatly to be deplored. But I see no good reason why the personal income tax should effect such a prohibition—*especially since the same results could be attained by tax-free reorganization or recapitalization and exchange of stock*. Deliberate reduction in the value of the trading unit is often a legitimate and commendable object of corporate policy. While a good case might be made for restricting such practices to dividends in even multiples per share (1:1, 2:1, etc.), this is hardly a proper matter of taxation policy. Besides, if we tax the common-on-common, what shall be done when par values are reduced, say by half, and new shares exchanged for old at two for one? A distinction can be made, to be sure, in terms of effect on corporate surplus; but the significant difference to shareholders will seldom be substantial.

If taxation did not stop the common-on-common dividend, moreover, it might often give rise to gross inequity, as between old and recent purchasers, and as between shareholders with accrued losses and those with accrued gains. Reaching some accrued gains that would otherwise never be realized or taxable, and reaching as ordinary income some which would otherwise enjoy the abundant generosity of Section 117, we should also overtax many persons while denying them corresponding subsequent offsets. (Some misguided person will doubtless make a statistical study to determine by how much, on balance, the avoidances estopped would exceed the overtaxings and how much the Treasury stands to gain or lose by the choice of procedures; but sounder decisions can, I think, be reached more easily without such data than with them!) If this difficulty arises with all taxable dividends, it is more serious with the stock dividend because of its greater irregularity.

It will be argued, of course, that the ordinary stock dividend *facilitates* wholesale avoidance with respect to undistributed earnings. Suppose a company earns 10% annually and "pays" only annual stock dividends, one share for ten. Selling his dividend stock, with cost apportioned, the

stockholder can realize his full share of the earnings annually, while exposing himself to tax only on a very small (albeit increasing) fraction of his income. However, the stock dividends facilitate avoidance only for the non-saver who cannot easily borrow the increment, and only for the small shareholder in any case. The large shareholder can always realize his increment by selling each year 10% of his remaining shares, without any dividend.

If *Eisner v. Macomber* should be overruled, the result will not be very important for its effect on procedure as to stock dividends. Repudiation of the argument and dicta in that case, however, should leave the way fairly clear for really important reforms, e.g., treatment of shareholders like partners (which strikes me as undesirable for practical reasons) or treatment of every transfer of property, whether by sale, gift, bequest, devise, or inheritance, as a "realization" by the transferor of the value at time of transfer.

The above material is reproduced from a memorandum prepared nearly a year ago, when definitive overruling of the *Macomber* decision seemed a real and imminent possibility. The first part may serve here usefully to restate, in a much-discussed special context, the main considerations with which we have sought to support our basic proposals: for constructive realizations at gift or death, for full inclusion of capital gains and full deduction of capital losses, for generous carry-over provisions, explicit and implicit, and for averaging rebates. The last part should serve to indicate that elegant and effective solution of the particular problems is simply impossible within the general framework of existing law and its realization procedure. Some of the particular proposals are certainly questionable, if not clearly ill-conceived. At the least, however, they should afford a useful commentary on the shortcomings of the law within which they were intended to operate.

Within the scheme of procedure advocated in this tract, these special problems all become easily manageable if not unimportant. Thus, we avoid entirely the impossible (constitutional!) question of *whether* a particular receipt is categorically income or not-income. *Whether* a particular receipt should be taxed as income disappears as a real question, being displaced by the sensible practical question of *when and how* it shall be taken into account in measuring or calculating income.

Under our procedure, however limited the taxpayer's basis-freedom in other details, the central rules clearly should afford wide latitude or *carte blanche* for basis-apportionment in the case of all stock dividends, stock

rights, and exchange of shares during recapitalization.²⁹ The present sharp, arbitrary, and constitutionally uncertain line between taxable and non-taxable dividends would disappear completely.

Shareholders properly would have an indefinite number of options, ranging at least between the extremes (a) of reporting as income the value of shares received, as for the common-on-preferred and *most* preferred-on-common dividends now, without any basis adjustment for the old shares and (b) of reporting no current income but apportioning the basis of the old shares between old shares and dividend shares, on any reasonable formula, if not with the full freedom which would permit, *inter alia*, the zero basis for dividend shares. Moreover, the *same* rules or options might cover all kinds of stock dividends—common-on-common, common-on-preferred, preferred-on-common, preferred-on-preferred, etc. Furthermore, the narrowest basis-freedom here contemplated would eliminate all serious discrimination or differentiation between cash dividends and stock dividends. While the shareholder presumably would report all cash distributions as current income, freedom to adjust his shares-basis, notably for extraordinary dividends or in conformity with changes of market value, would in fact make the options on cash dividends much like, if not identical with, those on other distributions.

Certainly, the present intricate mandatory apportionment in the case of stock-rights,³⁰ small and large, could be happily thrown overboard bodily and replaced merely with an injunction against carelessness or fraud in accounting integrity as to bases. Where rights-sales involve relatively small accounts, the taxpayer should be advised and urged to report the proceeds currently and to avoid complicated basis-adjustments. Incidentally, here is one more case where cumbersome temporal distinctions should be weeded out of statute and Regulations.

It thus seems not extravagant to claim that our procedure offers an elegant and definitive disposition of the vexed stock-dividend question. It permits radical simplification of relevant sections of statute and Regulations. It offers vast relief to the courts from an impossible (if self-imposed) task of legislation and technical administration.³¹

²⁹ See also Reorganization, p. 32 *supra*.

³⁰ Reg. 111, § 29.22(a)-8 (1946).

³¹ This task is as unbecoming to the judiciary as it is obviously beyond the competence or purview of that strange, traditional, parochial learning which is the intellectual certification of great chancellors. Judges perhaps can be taught, in a few generations, to apprehend something of the simple conception, accounting integrity. Such apprehension is all that should be expected or required of them, at least as regards constitutional questions of income-tax procedure. With such common-sense equipment, they may decide tax issues, writing opinions with-

"FICTITIOUS GAINS" (PRICE-LEVEL CHANGES)

Now a few words on a common apology for special treatment of capital gains, namely, that such gains often (sic) reflect mere reduction in the value of money. Thus, it is said to be improper to tax as income even a realized gain of, say, \$100,000 on property purchased in 1915 for \$100,000 and sold in 1920 for \$200,000, if the price level meantime has doubled. This view will appeal to sophisticated minds unsullied by contact with actual income accounting or tax procedure—although more sophistication is required to see the (much) nonsense than the (little) sense of it.

A slight demurrer may be offered immediately: Are such gains *commonly or largely* fictitious in the sense implied? Many doubtless were thus fictitious during the Revolution, during the Civil War, and during World War I—and, thanks again to inadequate taxation, will be during at least the early 1940's. But what of such gains during less abnormal years? When were they substantially fictitious during the lifetime of Section 117 and its differently numbered predecessors? Must we ruin our peacetime income tax merely to prevent its taxing "fictitious" wartime gains?

A second demurrer bites even deeper: Supposing that fictitious gains are mainly an incident of wartime inflation, is it really bad to tax them after all? Are the inevitable inequities of wartime inflation mitigated or aggravated, on balance, by taxing such gains as income? The answer ("mitigated") is almost ridiculously clear, once the significant question is properly formulated. The capital gains of rapid, emergency inflation are gains of residual or equity claimants—of stockholders, fee owners, holders of real assets. However fictitious they may be to economist (hyper)sophistication, they are pathetically real to bondholders, mortgagees, and annuitants! Income taxes do not pay people for having negative incomes, real or fictitious. Until they do, we certainly should leave well enough alone as regards "fictitious gains." After inflation, there would be little sense in coddling the fictitious element in "*mere*" dollar gains, unless we were prepared to reimburse *all fixed claims* for their losses in *real* values. If the problem of inflation were as simple in fact as is implied by this popular

out recourse to ponderous sophistries and labyrinthine rhetoric which, I infer, has better use in the more private mysteries of professional scholarship and ceremonial litigation.

Incidentally, the vast reduction here contemplated in present burdens of legitimate activities of the higher judiciary will appeal especially to those who anticipate millennial improvement of our political system out of the extra-curricular or avocational activities of learned justices. It is doubtful if any good has, on balance, been achieved by pushing the judiciary out of the executive front door (redistribution of veto powers) while welcoming it at the rear as part of an inner Cabinet or as arbiter in the selection of top personnel. The powers lost were at least exercised openly and with large opportunities for effective public remonstrance, both by dissident soothsayers and by others.

argument against full taxation of capital-gain income, then there would be little reason ever to be worried about inflation or opposed to traditional insanities in war finance! The argument's real import is that capital-gainers should be spared even indirect or slight participation in the financial burdens of war, and their share of taxes, as determined by "normal" procedure, lifted from them and imposed upon those whom wartime inflation had dispossessed.

The plain fact is that inflation is bad; that there are no trick schemes for having it without having its bad effects; that it does upset equitable taxation, along with equity in almost all other financial relations; and that the only good way to avoid the bad effects of inflation is to avoid inflation! These are widely accepted axioms or truisms in other areas of economic inquiry; but ideas, academic and popular, about public finance are much like money, viz., subject to Gresham's Law. The one here examined is perhaps the cheapest and shabbiest now in circulation.

A third and now gratuitous demurrer is similarly decisive. If capital gains should be translated into real terms by price-index corrections before being taxed as income, is it proper to confine such pleasant adjustments to those holders of equities and real assets (ignoring now the harder problem of fixed-money claims) who happen to *alienate* their properties and to alienate them "whole"? Is it reasonable to make this basis-adjustment, by a price-index correction for money-depreciation, for sellers of stocks and real estate, and to deny similar adjustments for depreciation and depletion bases, i.e., for useful people who "alienate" their assets by using them up in their business enterprises? If not, does anyone really propose that we correct all tax bases for price-level changes? Incidentally, shall index corrections which convert fictitious losses into real gains (money having appreciated) be consistently applied? Shall index corrections of fictitious gains produce deductible losses when the corrections yield negative results? And, after inflation, what shall elderly bondholders do with the vast deductible losses which index corrections, consistently applied, would afford to them? Finally, what would happen to post-inflation tax revenues if index corrections were *half*-consistently applied (i.e., ignoring fixed claims)—would the *post*-inflation period ever arrive?

ENTERPRISE (INCENTIVES)

(1) *There should be no taxation of business as such and certainly no such taxes confined to incorporated business.*

Corporations and other enterprises, of course, should pay in rem levies in the same manner, and to the same extent, as natural persons. Real or

tangible property which they own should be assessed and taxed like other such property. Such propositions, while seemingly trite and self-evident, have crucial negative implications, for corporate property seldom is so taxed. The practice and tendency in property-tax administration and legislation is to convert this levy into a tax on business as such, and to differentiate increasingly between corporations or enterprisers and other proximate owners or fee-holders. This tendency is manifest clearly in "unit assessment," in the taxation of "corporate excess," and, generally, in the use of earnings data and stock-market prices in the appraisal of corporate property—not to mention the wide differences, between businesses and other owners, in the extent to which particular classes of property (e.g., intangibles and personal tangibles) are in fact subjected to tax. We are not here concerned with state and local taxation; and there is certainly no easy solution, either in legislation or in administrative procedure, for the problem posed; but it does perhaps give meaning and concrete reference to the above policy prescription.

As regards the federal tax on corporate income, and the excess profits taxes, the prescription is unambiguous, and its implications clear.

It is the business of enterprises to produce goods and to make money. Given proper rules of the game, formal and conventional, and a structure of law designed to facilitate transactions and to canalize them in accordance with the public interest (e.g., away from excessive power concentration and monopoly), enterprises should be free from arbitrary influences on their actions and crucial decisions. In particular, the influence of taxes on production, price, and investment policies should be minimized. Some will discern in these remarks an injunction against use of taxes for purposes of control—but more on that later. The important injunction is not against taxation as an instrument of deliberate regulation, but against resort to corporation taxes as a too easy political solution of revenue problems. It is not so much deliberate control purposes which cause trouble, as it is the unintended, capricious, and perverse controls which are a by-product of revenue measures informed only by political fear of natural-person, voter taxpayers.

The ideal situation is one in which business decisions are uninfluenced by tax considerations. But no tax on business as such can be neutral as regards such decisions. If other available taxes were absolutely inadequate, we would be under the necessity of working out the least unfortunate compromise—taxing business as need required but constructing the levies carefully to minimize arbitrary (undesirable) influence on business behavior and incentives. (Pursuing this line of approach, discerning inquiry

would probably fix upon a retail sales tax as the least objectionable kind of levy in this area—and upon excess-profits taxes as the most undesirable.) Fortunately, however, such compromise is not unavoidable.

It is possible to confuse and to confound any discussion of real tax issues by introducing vague and undisciplined conjectures about incidence. As regards our federal corporation taxes, however, some significant truths about incidence are both fairly simple and obvious and also rather important. The *impact* of these levies is simply upon the stockholder or residual claimant and, consequently, upon the rate of return on equity capital. This effect, through the inevitable arbitrage of security and investment markets, is in turn transmitted over the whole field of investment opportunities, with change in interest yields, interest rates, and prospective returns on new real investment (the “marginal efficiency of capital”). There will, of course, be no end of minor repercussions, including some capricious changes in the direction of new investment (e.g., toward lines of business where the corporate form is less dominant or less indispensable.) For many practical purposes, and for ours here, it suffices to regard the taxes as falling or bearing in fact upon common shareholders—especially since interest rates and bond yields are so largely influenced independently by governmental monetary and borrowing measures.³²

³² The discerning economist will detect here a deliberate evasion of hard, or extremely involved, analytical questions. If industrial and labor competition were fairly free and substantially effective, the main effect of corporate income taxes would be either (a) to drive firms wholesale out of the corporate form or, failing such result on a large scale, (b) to bring about (1) substantial lowering of the marginal (private) efficiency of capital and of interest rates and (2) substantial redistribution of investment or resources generally as between lines of production “requiring” incorporation and other lines. Thus, to note a single but actually crucial contrast, in a highly competitive system such taxes would have small or negligible long-term effects on wage rates.

It is commonly possible to carry over the results of competitive price theory to the actual world with only minor qualifications. In many cases, the difference between effects of a tax under the assumed and the actual degrees of competition is not crucially important. This, however, is not one of those cases. Addicts of Robinson-Chamberlain tricks will offer to take over with “applicable,” “realistic” analysis; but *careful* use of their methods will, I think, merely demonstrate that their methods, like the orthodox ones, are not appropriate either—good economic theory will simply indicate, whatever its vocabulary, that the *answers* are to be found, if at all, otherwise than by economic theory as such—by institutionalists, if you please, but probably not by any self-styled institutionalist. At any rate, if one would seriously investigate the actual *incidence* of a corporate income tax, it is my now firm conviction that one should focus attention upon the consequent changes it causes, not *within the* economic system but *of the* economic system.

Consequently, we shall here focus attention upon the more obvious and truistical aspects of incidence, namely, impact or first-stage incidence. This is about all one needs for our present purposes, e.g., to indicate effects on bond versus stock financing or on the “quality” of enterprise.

I pass over, in this methodological footnote, such questions as: (1) Does the “new economics” ever do more than play tag with the old duopoly problem and always lose? (2) Is it good form, on every page, to solve an unsolvable problem by sheer prestidigitation or self-hypnotism? and (3) Should economists be encouraged to commit mass suicide by purging their theory and their thinking of categories?

The policy question thus becomes very simple: Are these taxes, as exaction from shareholders, desirable forms of levy; and, so far as they affect business behavior, are the effects mainly good (or bad)? The answer, in both parts, is precisely and strongly negative. What is important here logically is the rigid exclusion of all question as to the fairness of the taxes *among corporations or enterprises*. If one is careful not to discuss corporations as though they were people, it should be clear that all proper questions of fairness relate to the individuals on whom the taxes really fall; and that, at the business level, we should confine attention to influences on business behavior as to prices, outputs, investments, and as to innovation, enterprise, venturesomeness, and such behavior qualities.

Equity and incentive considerations, thus sharply defined, point unambiguously in the same direction. Taxing shareholders heavily, like overtaxing or exempting any "income" by kind or source, flies in the face of fairness among persons. If we must have such equity anomalies at all, they should, in this instance, be of the opposite character. If we must discriminate, we should favor the risk-taker or residual claimant relative to the passive, fixed claimant or *rentier*. Likewise, at the business level, the tax system, if it cannot be neutral, should favor equity capital and discourage debt financing and trading on the equity.

The argument here may appeal also to those economists who stress relations between the marginal efficiency of capital (anticipated yield on new real investment) and interest rates (as determined by institutional factors and risk premiums). A tax on shareholders' income, like any exaction from property income over a large range of investment opportunities, must lower the prospective (and actual) return on new investment generally. The same tax burden, transferred to individuals as income-taxpayers, may in fact have little such effect, at least for the bulk of corporate investment. If the tax is payable by the company, executives will naturally take account of it in weighing the case for any proposed investment (or reinvestment). The prospect that the government will share heavily in profits, and only to a lesser extent (if at all) in losses, must make any undertaking less attractive. However, if the tax burden will fall only on shareholders, the effect on executive or managerial decisions will be both more remote and less substantial if, indeed, not usually negligible. Executives will generally try to maximize net earnings of the enterprise and to follow the line most likely to yield largest earnings, regardless of what may happen, on the various possible contingencies, to shareholders' income after taxes. Their shareholders typically will comprise persons and institutions whose marginal tax rates vary from zero (e.g., for exempt corporations like universities) to the maximum surtax; and, even where large

surtax-payers predominate, the management will expect to be judged and rewarded by what it delivers (in earnings, not in dividends!). Moreover, as already noted, the bias against risky commitments is in fact less marked in the personal than in the corporation tax and can and should be much less substantial than it now is. Shareholders will typically have other income against which to balance their losses as holders of particular shares; and they should enjoy carry-overs and averaging rebates which would be at best anomalous in a business tax.

To repeat, there should be no levies on business or concerns as such. The impact of taxes should be kept as far away as possible from the concern or enterprise, and from the sphere in which operating and investment decisions are made. This means that taxes should fall on the natural person or family as a consuming and saving unit or household, where their effect will be concentrated on consumption and saving and largely removed from productive enterprise and management. If—God forbid—we must tax shareholders *qua* shareholders, let's do it plainly, directly, and straightforwardly and give our good sense a chance to cry out against the folly.

(2) *Our taxes, singly and as a system, should be totally purged of discrimination against risky, venturesome, innovating, long-odds enterprise or against individuals as participants (investors or personal enterprisers) in such concerns.*

If there is to be discrimination, it should run the other way. In both directions, however, it involves sacrifice of equity objectives. This is certainly not the time to propose positive subsidy or tax preferment, in any case, for there remains a large task of weeding out unintended accumulations of penalties and adverse discrimination in the tax system as it stands.

In a pure free-enterprise system (and the actual system may still usefully be treated as approximating that type in some essential aspects), every firm faces a wide range of economic uncertainties, of contingencies ranging from total loss to enormous profits. If entry is free, the average return may be expected to approximate the return on government bonds. But there will be enormous dispersion about that average; and, while few may attain large profits, the contingency or long-odds expectation of such gains is crucially important for incentive or motivation.

Any taxes on business as such, especially on its net or "excess" earnings, must somewhat impair incentives and inhibit enterprise. For individuals (and their heirs) it is possible to effect substantial adjustments over the years, so that losses are actually taken fully into account in determining their aggregate (direct) tax payments—although actual legislation is very

remiss on this score. Fortunately few natural taxpayers have negative or negligible aggregate incomes over long periods. With enterprises, this is commonly or typically the case. Besides, offsetting of past losses against future incomes makes little sense for firms, since ownership may change completely or substantially during their lives. There is no good reason for discriminating grossly between a new corporation which acquires the plant of a deeply insolvent defunct firm and another which merely acquires the securities of an identical insolvent. Bygones must largely be bygones, in business taxation as in business itself.

In any case, conventional business taxes necessarily result in governmental sharing of temporary net earnings, without adequate offset for losses, prior or subsequent, and in governmental sharing in the profits of successful firms but not in the losses of other enterprises. Thus, such taxes systematically alter the pattern of expectations and experience as regards gain and loss contingencies—and in a manner prejudicial to risk-taking. It is a kind of “heads-you-lose, tails-I’m-not-playing” game in which it is naturally difficult to interest other people. It is a kind of disturbance peculiarly unamenable to satisfactory automatic correction through the pricing process. Even under highly competitive conditions in all markets, the effect on the “quality” or dispersion of expectations would remain, as would some impairment of the spirit of enterprise. While lowering “pure” interest rates, moreover, it would serve to increase the element of risk premium, thus inhibiting borrowing as well as equity investment.

There is much talk, and now some use, of more generous loss provisions, for both carry-back and carry-forward. But, while to be commended as expedients, such schemes rest unduly on the same bad arguments which support the taxes themselves. At bottom they imply that corporations should be treated as natural persons. That there is something very wrong here is manifest, if not otherwise, in the fact that potential loss deductions of corporations, like their invested-capital bases, can be and are bought and sold as a kind of property. There is little really to be gained by building sense into the superstructure of a tax which makes no sense at bottom.

The surest means of avoiding penalty on venturesome enterprise in our business taxes is simply to get rid of them outright. To do so, of course, would perhaps leave stockholders in an unduly favorable relative position. Let us pass over that matter for the moment.

Given repeal of the corporation taxes, there remains the task of finding and weeding out biases in the tax system against persons as investors and direct participants in more risky business ventures. This task turns out to be largely that of removing the penalty of present taxes on *fluctuations*

of taxable annual income. Here much good can be done by more generous provision for carrying net losses forward and backward, by de-segregating and enlarging capital-loss deductions and, notably, by providing generously for rebates where persons with highly unstable incomes initially pay more, over a period of years, than persons with stable incomes of the same average magnitude.

Congress and the Treasury are acutely allergic to averaging proposals. English experience has given a bad name to averaging in general. Indeed, a strong case can be made against the familiar moving-average device. However, nothing but blindness and lethargy excuse failure to eliminate from our personal tax a bias and discrimination which stands condemned both by its great unfairness and by its narrowly economic effects, and by each decisively. Only mere reluctance to give up a nickel once collected can explain inaction in this matter. There is no need for an elaborate scheme; and excellent simple ones are certainly available. Making a start which must satisfy the worst stickler for simplicity, we could consider leisurely the case for less crude adjustments. For this particular reform, what is needed evidently is just a lot of yelling from aggrieved taxpayers and from disinterested students. No one denies the need for the measures in question, yet no one can be prodded into doing anything about it. The real bottleneck, here as in the inflation problem, would appear to be in the Treasury. Incidentally, averaging rebates, under the simplest rules, would reduce the need for loss carry-overs and permit great simplification of the law at many points.

(3) *The tax system should carefully be purged of any bias against small or moderate-sized firms relative to the giant enterprise aggregation.*

In practical implications, this proposal is largely identical with the one preceding. The small firm is more commonly a new and venturesome enterprise. It is inherently more risky, i.e., exposed to a wider range of gain and loss contingencies. Contrariwise, the giant corporation faces relatively narrow uncertainties and fluctuations. It may have huge excess profits in some sectors but is unlikely as a whole to be heavily exposed to taxes on "excess." By its spreading and diversification of risks, it avoids also the extremes of income fluctuations through time. If not much diversified in spite of its size (integrating many stages of a production process or combining many similar firms horizontally), it will commonly enjoy the protection of monopoly power against great losses—either in its own industry leadership or in the easy collusion, tacit or other, with "competitors" of similar size.

The elegant solution again is abolition of the corporation or business taxes, for their bias against smaller firms cannot be eliminated—neither

can it be compensated satisfactorily by progression and exemptions of the kind found in present laws.

The adverse bias in the personal tax itself is conspicuously important, for small enterprises are commonly family enterprises or personal-service corporations (whether or not so classified by rules of law). This bias can be only mitigated by spreading of losses; it cannot be entirely eliminated by any averaging arrangements that are procedurally feasible. If perfection is unattainable, however, there is still no excuse for not doing what can so easily be done by averaging rebates. The arbitrariness of taxes on persons with highly unstable "enterprise" incomes can largely be removed, and with great gains in fairness and in incentives.

A question remains whether corporation taxes should be used for the purposes of deconcentration and anti-monopoly policy. The answer, I think, clearly is "Yes," if politics is unwilling and unprepared to deal seriously with excessive concentration of industrial control by more straightforward and more appropriate measures. The present situation, however, is not yet serious enough or, rather, the prospect for sounder measures is not yet sufficiently hopeless, to warrant recourse now to radical progression³³ in corporate taxation. It may soon be wise to invoke this last-ditch expedient, in default of a real anti-trust program—and prominent corporate executives have every reason to prefer the most progressive business tax to the far better alternative controls—but the necessity of resorting to such ill-contrived weapons against industrial syndicalism will perhaps only reveal how small is the chance of preserving economic or political liberty. When a good cause can be or is pursued only with such bad measures, the cause is perhaps really hopeless.

FINANCIAL EFFECTS

The absurdly perverse influence of corporate taxes on business finance is now widely recognized and deplored. Whether one accepts the supposition that such taxes fall on the shareholder or, alternatively, stresses the diffusion of burden over all investment assets, the fact remains that at the corporate level they discriminate grossly against equity financing³⁴ and

³³ The slight and "early-stage" progression of the present (and recent) corporate income tax has, obviously, no meaning or significance for monopoly control. To promote sound deconcentration, progressive corporate taxation would involve enormous exemption (say, \$10 millions), would touch no moderate-sized enterprise, and would be steeply progressive, at least, only among real giant corporations representing aggregations of large independent manufacturing units. Such a program would, in fact, not properly concern itself much with tiny companies or really small firms but would seek rather to differentiate sharply between large, specialized, single-plant corporations and giant enterprise-aggregations.

³⁴ The relief recently granted to public utilities, while objectionable in its arbitrary limitation (to preferred stock and to utility corporations), indicated awareness of an anomaly and is perhaps an omen of better things to come.

in favor of debt³⁵ (also, against property purchase and in favor of acquisition by rental contract).

It is sometimes proposed (I once had this brainstorm) that the anomaly be mitigated by withdrawing interest deductions under the corporate tax. Such legislation, announced or seriously predicted as possible, would provide an exciting spectacle in the securities markets! It would suddenly shift all financially marginal companies into deep insolvency and render insolvent many firms now in good or excellent financial repute. Most of our railroads would be completely sunk overnight. A moment's reflection thus suffices to exclude this "remedy" simply on vested-interest grounds. Moreover (if one may whip a beast already killed), the problem of lease versus ownership would remain and in a more glaring light. If we then excluded rental deductions, we should find ourselves with an unintended penalty against even minimal integration! Going further with this confounding of confusion, we should perhaps shift to a value-added tax as a recourse of desperation—which, by the way, would create its only possible claim to serious attention.

Being in a bad mess, and estopped from backing out, we might move forward by permitting full deduction for all dividends paid (as with the mutual investing companies now). This would really be getting somewhere—and is perhaps as much improvement as would be endorsed by specialists who seem forever terrified by the possibility of improving anything "too much." Whether we should stop at this point, with that "awful" undivided profits tax back on our hands, is a question which cannot be answered wisely save on assumptions about the future treatment of capital gains and capital losses. To my taste the answer is flatly "No"; but explanation must wait a bit.

The case against corporate bond financing is now widely recognized and conceded. Older textbook maxims of corporation finance (which largely rationalized and justified existing financial structures, notable in railroads and utilities) are, since the '30's, not in good repute. The period of the '20's was marked by a sound and striking trend; and recent efforts of the SEC perhaps adumbrate sound government control over corporation finance in a far wider field. Such control, seeking to restrict debt financing in favor of enlarged equity capital, is even more desirable than prevailing discussion has recognized. Surely tax laws, at least, must be changed to eliminate a wholly perverse influence.

Heavy fixed (or floating) debt is obviously undesirable for the single

³⁵ The anomaly is absurdly manifest in current behavior of our suddenly prosperous railroads. Companies in admirable position to retire excessive debt simply cannot bring themselves so to use available funds because of the great increase in their taxes which such action would involve!

enterprise in an unstable economy or industry. Any temporary adversity is likely to produce insolvency, with grave losses, not only for the stockholders but also for senior securities and the enterprise as a whole, through the great costs of reorganization and the inevitable disturbances of operations and business relations which insolvency involves. Moreover, even if technical insolvency and reorganization are avoided, the enterprise and the whole economy may gravely be damaged by the practices necessary in avoiding it. Thus, physical properties may be abused merely to prolong technical, legal solvency, to avoid definitive squeezing out of shareholders, management, or "control" in bankruptcy or reorganization, and thus to gamble (with nothing to lose!) on remotely favorable contingencies. The physical plant may thus be "bled white" to meet current obligations, especially interest payments and bond maturities, in the pursuit of mere liquidity.

These things are doubtless widely understood. What is less clearly apprehended is the aggravated instability of the whole economy, and the obstacle to deliberate monetary stabilization, which corporate debt structures produce in their aggregate. It should be obvious what desperate and frantic struggles for corporate liquidity mean in total where the economy has slipped into a general recession which, debt structures apart, might prove innocuous and short-lived. They may well mean the difference between a mild recession and a precipitous, catastrophic deflation.

The ideal situation, for economic stabilization, is one where corporations (and other enterprises) are wholly financed by equity capital. The greatest threat of deflation, of course, lies in enormous short-term debt—witness our anomalous governmental guaranty of the demand obligations of *private* banks. But the difference, in this respect, between long and short-term debt is only one of degree. All debt involves short-term fixed claims for interest payments; and all long-term obligations become short-term obligations sometime.

Whether this ideal financial structure is something we should seek to attain or to approximate closely (but gradually) by change in corporation and banking laws, is debatable—and often dismissed as a question which reveals the questioner as radical or insane. Few competent students, however, would now reject the all-equity-capital goal as a directional guide for more moderate change or reform. And none, I think, would deny that our present corporation taxes have, on balance, a wholly bad and serious effect on the financial practices of firms and on the financial structure, both of individual companies and of the total private economy. This consideration alone demands prompt and radical tax reform—and the same kind of reform indicated by the other considerations.