THE IMPACT AND BURDEN OF WARTIME CORPORATION TAXES

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I

The corporation tax structure as most recently revised in 1942 is yielding an unprecedented volume of revenue. Total tax liabilities of corporations in 1942 will be ten times as large as they were in 1939 (Table I), the major part of the increase coming from an excess profits tax which was not enacted until 1940. This tax alone accounts for almost $8 billion, or two thirds of total corporate tax liabilities in 1942.

But in spite of the huge increase in corporate taxes, it is estimated that income after taxes for all corporations will have increased from $4 billion in 1939 to over $7 billion in 1942. For profitable corporations, alone, income after taxes will have increased from $6 billion to over $8 billion. These increases in income after taxes are explained by the fact that corporate income before taxes rose from over $5 billion in 1939 to almost $19 billion in 1942.

A comparison of income after taxes in 1942 with 1941 of corporations in general shows an increase of 4%. However, Treasury estimates indicate that net income after taxes for profitable corporations, alone, will be less in 1942 than in 1941. The estimated increase of net income after taxes in 1942 over 1941 results from a decline in the estimated deficits of unprofitable corporations. Therefore, many individual corporations will have suffered diminutions in net income in 1942 as compared with 1941.[1]

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[1] An examination was made of the earnings records of 373 large industrial corporations taken from the sample used by the Board of Governors of the Federal Reserve System in its series of quarterly earnings and dividends. A considerable number of these corporations reported substantially less income after taxes in the first three quarters of 1942 than the comparable period in 1941; income after taxes in 1942 of two-fifths of the sample fell more than 25 percent below 1941. Care should be taken in interpreting these data since they are based on *book* rather than *tax* data. Taxes were overaccrued to the extent they were based on the House version of the Revenue Bill of 1942 rather than the final act, passed in October. Furthermore, contingency reserves have been deducted. A sample of 40 large corporations exhibited an increase of 60 percent in reserve deductions in 1942 as compared with 1941; this increase represented 7 percent of 1941 net income.

TABLE I

NET INCOME AND TAX LIABILITIES OF CORPORATIONS, 1939-1942
(In millions)

	1939 actual	1940 actual	1941 estimated	1942 estimated
1. Net income, profitable corporations[a]	$7,232	$9,523	$15,950	$20,000
2. Deficits, unprofitable corporations[a]	1,977	2,226	1,700	1,000
3. Net income, all corporations[a]	5,256[b]	7,296[b]	14,250	19,000
4. Normal tax and surtax	1,216	2,144	3,750	3,900
5. Excess profits tax	—	375[c]	3,400	7,700[d]
6. Total taxes on income	1,216	2,519	7,150	11,600[d]
7. Net income after taxes, profitable corporations	6,016	7,004	8,800	8,400
8. Net income after taxes, all corporations	4,040	4,777	7,100	7,400

Sources: TREAS. DEP'T, STATISTICS OF INCOME, 1939-40, Pt. 2. Treas. Dep't, Div. of Research and Statistics, 1941-42.

[a] Excludes dividends received from domestic corporations, but includes tax-exempt interest.

[b] Due to rounding, individual items do not necessarily add to totals.

[c] Estimated.

[d] Net after postwar refund.

The impact of corporation taxes on particular corporations depends on the diverse situations in which they find themselves as a result of the war, as well as the particular taxes bearing on them in these situations, and their ability to pass on the burden of these taxes.

There are two general situations in which the impact of war taxation is especially heavy. First, increased normal and surtaxes bear heavily on corporations with stable or declining earnings before taxes during the war years. Corporations in this position, especially if they have outstanding preference shares, *e.g.*, public utilities, may find it difficult or impossible to maintain common-stock dividends at the prewar level, or even at reduced levels.

Secondly, the corporation with earnings greatly increased over their prewar level as the result of greatly expanded war production is inevitably subject to very high effective tax rates. These corporations often face cash shortages because of heavy working-capital demands and maturing tax liabilities.

In contrast, the burden of wartime taxation is much less severe for two other classes of corporations. First, corporations with high base-period earnings may earn a high rate of return before being subject to excess profits taxation. Secondly, corporations which customarily earn very low rates on large amounts of invested capital may substantially increase their earnings free of the excess profits tax. For example, with their large invested-capital credits, railroads have not been subject to high effective tax rates despite the tremendous increase in their earnings.

II

It is not only the impact in the first instance of wartime taxes on corporations which determines the relative merits or defects of the wartime corporate tax structure, but also their incidence and effects. Thus, it is necessary to consider how these taxes are affecting the behavior of individual firms. Are they weakening the resistance to rising costs? Are they encouraging inefficiency, waste, and socially unnecessary expenditures? Are they retarding production? Finally, are they discriminating against stockholders by forcing upon them disproportionate reductions in current consumption?

Definitive answers to these questions cannot be given. Our experience with wartime taxation has been too brief to permit empirical tests of its effects on business practices and policies. In any event, the tax program is but one of many abnormal factors influencing the behavior of business firms in wartime.

The following is a preliminary appraisal of the burden of wartime taxes. In a situation in which the choices of businessmen with respect to the products they will produce and the prices they will charge are strictly limited by government controls, economic analysis operating within a peacetime frame of reference may have little relevance. Only within the framework of priorities, price and wage controls, and the role of the Government as the principal buyer, can the burden of wartime taxes be assessed.

1. Wartime taxes and costs

The excess profits tax may affect costs by affecting the efficiency with which labor and other resources are used in production, and the prices which businessmen are willing to pay for these resources.[2] It has been held that high excess profits taxes operate on both of these determinants of cost so as to impede the war effort. High marginal rates of taxation, it is argued, leave the businessman with little incentive to resist demands for increased wages and materials prices, or to exercise rigid controls over operations. Consequently, it is concluded, high tax rates lead inevitably to higher factor prices and increasing inefficiency in the utilization of labor and materials.

These considerations have important implications. Increases in wage rates, if they fail to increase the production of consumers' goods, tend to widen the inflationary gap between disposable income and consumable goods and services. Inefficient utilization of scarce resources either will have a similar effect, if the supply of consumers' goods currently available is reduced, or will decrease the output of war material. Thus, instead of being anti-inflationary, high excess profits taxes on corporations may contribute to the upward movement of prices. Although they reduce the opportunities for profit inflation, such taxes may well encourage cost inflation. Of these two forms of inflation, the latter may indeed be the more serious; a profit inflation may be more easily corrected in the postwar period than a cost inflation.

While high marginal rates of taxation may produce a situation favorable to rising costs, it does not follow that the present excess profits tax will necessarily raise prices by increasing costs. In the first place, the precise point at which taxes begin to weaken the profit motive appreciably is not rigidly fixed in the determinations of

[2] The effect of the corporation income tax on costs is probably not very significant, except to the extent that lower rates are anticipated after the war. This latter consideration may encourage expenditures which would not ordinarily be made at the present time.

businessmen. Secondly, the importance of the profit motive is reduced in time of war. Certainly, the decisions of businessmen in wartime are affected not only by high taxes but by other factors as well, some of which may offset or nullify the influence of the tax factor.

Effects on productive efficiency

The proposition that an 81% rate of taxation[3] on excess profits will encourage waste and inefficiency rests on two assumptions, neither of which can be accepted without qualification. One of these, namely, that business decisions are motivated primarily by short-run profit considerations, appears to be at variance with the admitted concern of most businessmen over their postwar operations. To allow inefficient and wasteful practices to spread throughout plants engaged in war production would be to weaken the postwar competitive position of such plants. If the short-run view is not the predominant one, a temporary tax, even if it were imposed at a 100% rate, would have less effect on business decisions than is commonly supposed.

The other assumption underlying the proposition that high war taxes encourage inefficient operations is that the performance of those persons who exercise direct control over business operations is determined in part by the level of profits after taxes. Especially in large enterprises, ownership and management are often not identical; the responsibility for efficient operations lies on management rather than on the owners. To the extent that the rewards to management are a function of the level of profits, the best measure of managerial efficiency is provided by profits before, rather than after, taxes. Moreover, management itself may be motivated by other considerations than the maximization of profits either before or after taxes. It may, for example, view efficient operation as an end in itself. Whether high taxes have an appreciable effect upon the quality of management, especially in the case of large enterprises is, therefore, open to question.

A stronger case can be made for the proposition that the excess profits tax may encourage expenditures which would not be made in its absence, if such expenditures are likely to yield benefits in the postwar period. The most obvious example of this kind of expenditure is advertising. A dollar spent for advertising in 1939 represented a net outlay of 81 cents. However, a dollar so spent in 1942 by a corporation subject to the excess profits tax represented a net outlay of only 19 cents.[4] A businessman who was in doubt whether an advertising dollar was worth 81 cents may be easily convinced that it is worth 19 cents. In other words, high taxes enable corporations to purchase valuable goodwill and prestige at little cost to themselves.[5]

[3] This assumes a nominal rate of 90%, less a postwar credit equal to 10% of the tax which may be used currently to the extent of certain reductions in debt.

[4] If the dollar had not been spent, the taxes on it would have been 19 cents in 1939 and 81 cents (taking into account the postwar credit) in 1942.

[5] The benefits from advertising must generally be yielded in a period in which lower tax rates are anticipated, otherwise the benefit would be taxable at the same rate as the cost is deducted. Even if rates are expected to remain high, however, additional advertising outlays may be encouraged.

Other examples of this kind of tax-stimulated spending can undoubtedly be found in higher salaries paid to executives, in larger fees paid for the professional services of lawyers, accountants, and tax consultants, more properly treated in the following section, and in increased outlays for maintenance and repairs.[6] In view of an existing excess profits tax, these expenditures can be justified by the firm in terms of probable future yields in excess of small current outlays.

These effects of excess profits taxes on efficiency and economy of production are offset by a number of other factors operating in time of war.

First, the Government is now the principal buyer of the nation's output. Although the Government's ability to maintain a careful check on the operation of those firms from which it buys should not be exaggerated, it is none the less true that cost analyses and controls are used by the Government in the placement of its contracts. Secondly, the Government can allocate scarce manpower and materials to the most efficient producers. Thirdly, salaries are subject to governmental control. Fourthly, the allowability of such costs as professional fees, advertising, and the like, as deductions for tax purposes is dependent upon their reasonableness as determined by the Bureau of Internal Revenue and the courts. Finally, in some future year or years the firm's earnings may fall below its excess profits credit, or losses may be suffered. The carry-back of losses and unused excess profits credits, authorized by the Revenue Act of 1942, may be sufficient to wipe out taxable excess profits completely. In this event the net cost of expenditures would be increased more than threefold, that is, from 19 cents per dollar of expenditure to 60 cents per dollar of expenditure.

In combination, these factors cannot be counted on to offset fully the influence of the tax factor on the efficiency of operations. However, they substantially limit its scope.

Effects on prices of labor and materials

Excess profits taxes tend to weaken the resistance of employers to demands for wage increases by reducing the net cost of these increases to the taxpayer. As in the case of expenditures for advertising, the taxpayer may bear no more than 19% of the wage increase. On the other hand, demands for wage increases would be strengthened by the absence of high taxes on excess profits as much as, or more than, resistance to these demands is weakened by the existence of such taxes. In any case, the Presidential order designed to stabilize wages has undoubtedly limited, for the present, unwarranted increases in wage rates.[7]

Another basis for the claim that the excess profits tax inflates costs has been found in the nature of government contracts. It has been declared that the procedure of renegotiating contract prices places all government contracts, whether fixed-price or cost-plus-fixed-fee, on a cost-plus-percentage-fee basis. The experience of the last war

[6] Under-maintenance characterizes the operations of many firms at the present time.

[7] Furthermore, had the decree to stabilize wages been politically possible without a high excess profits tax, wage costs, as distinct from wage rates, might have increased. Labor might not care to exert a maximum effort if this merely increased corporate profits.

demonstrated that cost-plus-percentage-fee contracts encourage inefficient production. In the present war, it is claimed, the amount of profits on contracts, as allowed by the various price adjustment boards, is determined as a certain percentage of total sales. Total sales may be a function of costs. Thus, allowable profits become a function of costs, encouraging cost increases. If a firm attempts to maintain profits after taxes at a constant level, it will, in the face of increased war taxation, inflate its costs and thus secure larger profits before taxes. So, it is concluded, a vicious spiral is initiated; higher tax rates result in higher costs.

In view of the cost controls previously discussed, the danger of cost increases arising from the nature of government contracts appears to be limited. Furthermore, the percentage of profit allowed by the price adjustment boards is not purely mechanical. Recognition is given to the efficiency of the firm and the trend of its costs, the more efficient firm being allowed wider profit margins.[8]

On balance, no conclusive statement can at present be made regarding the effect of the excess profits tax upon costs. However, the increases in costs which might ordinarily result from an excess profits tax must run the gauntlet of many wartime controls, and are, thereby, undoubtedly minimized.

2. Wartime taxes and prices

In addition to the indirect effects which wartime corporate taxes may have upon prices *via* costs, such taxes may enter directly into the determination of price policies.

In peacetime the framework within which the firm must formulate its price policy is established by the competition both of other firms within the same industry and of other industries. The price policy of a given firm is conditioned by the price policy of its competitors, and intelligent decisions to alter prices must take into account possible repercussions upon the decisions of competitors. Moreover, the sole aim of the firm's price policy cannot be to maximize profits in the immediate future. Too high a level of profits might invite governmental regulation or new competitors to enter the industry, thus prejudicing long-run profits.

Businessmen usually insist that within this framework it is possible to shift higher income taxes onto consumers, while, until recently, economists generally have held this not to be the case.[9] These issues cannot be resolved here. It may be useful, however, to point out some of the changes wrought by the war in the framework within which price policies are formulated.

One important change is the new role of the Government as the ultimate purchaser of over half of the current output of goods and services; its control over

[8] Joint Statement by the War, Navy and Treasury Departments and the Maritime Commission, *Purposes, Principles, Policies and Interpretations under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended,* March 31, 1943.

[9] See E. R. A. Seligman, *Income Taxes and the Price Level,* in STUDIES IN PUBLIC FINANCE (1925); and W. H. Coates, *Memorandum on the Incidence of the Income Tax,* APPENDICES TO THE REPORT OF THE [COLWYN] COMMITTEE ON NATIONAL DEBT AND TAXATION (1927) App. XI. However, for a different viewpoint, see D. H. Robertson, *The Colwyn Committee, the Income Tax and the Price Level* (Dec. 1927) Vol. 37, No. 148, ECON. J., p. 566 (reprinted in ECONOMIC FRAGMENTS); DUNCAN BLACK, THE INCIDENCE OF THE INCOME TAX (1939).

the price policies of firms is increased. There is, nevertheless, a wide range of indeterminancy in the formulation of reasonable prices, within which contracting officers and price adjustment boards might allow for wartime taxes through higher contract prices.

Although contracting officers, knowing that most excessive profits will be recaptured by wartime taxes, may not haggle as long over prices as they otherwise would, the placement of orders on an individual-contract basis makes it unlikely that contracting officers could, or would, make direct allowance for wartime taxes. Furthermore, the process of renegotiation by the price adjustment boards makes available to the military establishment a further check on contract prices. The general position of these boards is reflected in the statement "that the reasonableness of profits should be determined before provision for Federal income and excess profits taxes."[10]

Aside from its regulation of war material prices, the Government, in wartime, controls the prices of consumers' goods and services. With purchasing power greatly exceeding the flow of goods available for purchase, the possibility of a price policy which transfers the burden of wartime corporate taxes to the consumer would seem greatly enhanced. However, the Office of Price Administration, the agency under whose jurisdiction has been placed the pricing of most consumers' goods and services, holds:[11]

> For price control purposes it is profits before taxes that are significant. The Congress determines, in its tax legislation, what shall be the distribution of the financial burdens of war —who shall pay the taxes and how much they shall pay. To permit prices to increase so as to cover income and excess profits taxes levied upon corporations, and thus to permit such taxes to be passed on by the corporation to the consumer, would defeat the intention of Congress.

A similar policy has been followed in the regulation of transportation and public utilities.[12]

This does not mean that wartime taxes may not indirectly affect prices. Because of the reduction in corporate income after taxes resulting from wartime taxation, the amount of reasonable profits before taxes allowed by public agencies may be more generous than would otherwise be the case. Indeed, the Office of Price Administration has stated: "So necessary was the expansion of output to our defense in the period prior to December 7, 1941, and to the successful prosecution of the war since that date, that the Office felt impelled to err in the direction of laxity rather than in

[10] Joint Statement, *op. cit., supra* note 8, at 7.

[11] OPA, THIRD QUARTERLY REPORT (for the period ended Oct. 31, 1942) 23.

[12] In the determination of public-utility rates, only peacetime taxes have been allowed as a cost. The Federal Power Commission has stated: "Increased tax burdens must be borne by the utility which enjoys a monopolistic position in the economic field, as well as by others who have no such advantage." Fed. Power Comm'n, Op. No. 80, In the Matter of Pan Handle Eastern Pipe Line Co. and others, Sept. 22, 1942, p. 31.

Transportation-rate determination by the Interstate Commerce Commission has generally not taken income taxes into account. Reduced Rates, 68 I.C.C. 767, 683 (1922) cited in Increased Railway Rates, Fares, and Charges, 248 I.C.C. 556 (1942).

the direction of rigor."[13] In the absence of wartime taxation, such laxity would probably not have been permitted.

This examination suggests that the price level is somewhat higher than it would have been in the absence of wartime corporation taxes. However, to the extent that the Government is itself the purchaser of goods and services, the net price paid (actual expenditures less tax receipts resulting therefrom) is the price which must be taken into account. As substantially less than 100% of wartime taxes are included in the prices actually paid, it follows that this net price must be less than it would have been in the absence of such taxes.

The same conclusion, however, cannot be extended to the prices of goods and services purchased by individual consumers. Increases in prices of consumers' goods will impose varying burdens on different income groups.

3. Wartime taxes and dividends

An appraisal of wartime taxation must also consider the effect of such taxation on the payment of dividends by corporations. This effect is of particular importance in assessing the burden of wartime corporation taxes on the individual owners of corporate enterprise, since, in some cases, dividend income represents their only current claim on the national product.

Furthermore, as consumable commodities become increasingly scarce and as prices rise, firms may strip themselves of working capital in order to meet increased demands for dividends by stockholders. Such a reduction of working capital would have serious postwar implications by increasing the difficulty of the postwar readjustment. On the other hand, failure of wartime taxation to siphon off possible increases in dividends as a result of increased profits would only increase the present gap between commodities and services available for consumption and disposable income.

The relationship between dividends paid[14] and corporate net income after taxes[15] for the period 1933 through 1942 as shown in Chart I below, does not include the years 1936-37 and 1942. The undistributed profits tax was in effect in the first two of these years, resulting in larger dividend payments than would otherwise have been the case. The line of regression (Chart I) indicates that for the period from 1933 through 1941, a change of 27 cents in dividend payments was associated with a change of one dollar in net income.[16] In the year 1942, however, although net income after taxes *increased,* dividend payments *decreased.* If the same relationship between net income and dividends in the period 1933 through 1941 had been maintained in 1942, dividends would have been $4,650 million, rather than $4,200 million.[17] To what can this seeming change in behavior be attributed?

[13] OPA, *op. cit., supra* note 11, at 26.

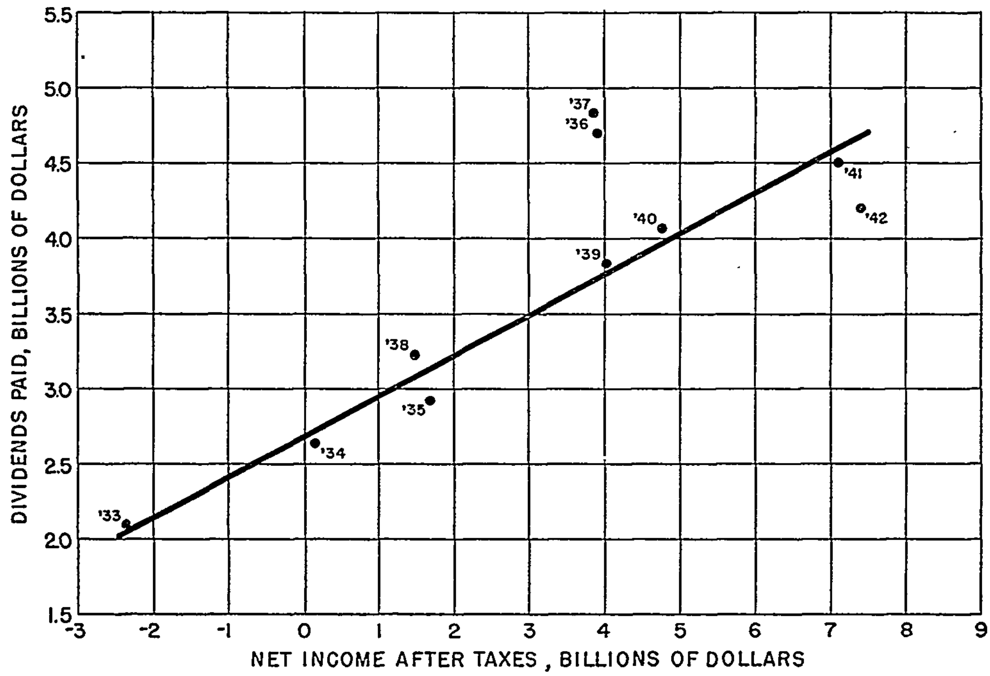
[14] Gross dividends paid, less dividends received from domestic corporations.

[15] Compiled net profit or net loss, less all taxes and dividends received from domestic corporations.

[16] The line of regression was $Y = .27X + 2679$ million; the coefficient of correlation was .99, and the standard error of estimate, $117 million.

[17] A recent estimate by the Department of Commerce is even lower—$3,983 million. See Tynan Smith and Robert Sherman, *Recent Trends in Corporate Profits,* SURVEY OF CURRENT BUSINESS, June, 1943.

NET INCOME AFTER TAXES AND DIVIDENDS PAID, OF ALL CORPORATIONS, 1933-1942
Excluding Dividends Received from Domestic Corporations



Source: For 1933-'40, U.S. Treasury Department, Statistics of Income, Part 2.
For 1941-'42, U.S. Treasury Department, Division of Research and Statistics.

In the first place, the proportion of the 1942 excess profits tax liabilities represented by the postwar credit (10%) has not been deducted from net income after taxes. For current dividend purposes, however, the postwar credit represents a commitment of funds in the same sense as taxes,[18] unless used for debt repayment. It may be as large as $500 million. If 1942 income were reduced by this amount, the relationship between income and dividends in that year would diverge less from the 1933-41 relationship.

Furthermore, it must be recalled that the increase in corporate net income after taxes in 1942 over 1941 is not attributed to an anticipated increase in aggregate net income of income corporations, but to a decrease in aggregate deficits of deficit corporations.[19] This factor alone would have reduced aggregate dividends as compared with aggregate income. That dividends were not more greatly reduced may imply a weakening in the working capital position of some net income corporations, particularly when the postwar credit discussed above is taken into account.

This latter point may take on further significance when the inadequacy of an annual determination of income is considered. Income may be overstated because

[18] Strictly speaking, this may not be true. Increases in the postwar credit may result in reductions in the amount of government bonds or similar securities which would otherwise be held by the corporation.

[19] See Table I, *supra*, p. 122.

of inventory profits, undermaintenance of assets, inadequate provision for depreciation, or failure to reflect currently a reduction in income owing to possible future losses. On the other hand, amortization of emergency facilities understates profits. On balance, taxable income may be overstated. If corporation management bases its dividend policy on such overstated income, the corporation may find itself with inadequate postwar reserves.

Finally, in a period of rapid expansion of output, as in 1942, cash demands for new facilities, additional inventories, and working capital, may require extensive plowing-in of profits. As long as taxes take a relatively small percentage of net income before taxes, dividends may be maintained in spite of this expansion. However, if taxes take a substantial portion of net income, expansion may be possible only at the expense of current dividends.

All of these considerations must be weighed in assessing the presence or absence of conservatism in corporate dividend policies in 1942. As yet, it would appear that corporate dividend policies, taken as a whole, have fully taken into account the wartime corporate tax program, and have reduced dividends concomitantly.[20]

4. Wartime taxes and production

The general relationship between war taxes and the level of production has been discussed above,[21] where particular attention was given to the effects of high marginal rates of taxation on productive efficiency. The excess profits tax may also affect the level of war output in a number of special situations.

The excess profits tax affects the availability of investment funds needed to finance increased production. This tax, generally speaking, makes no allowance for risks assumed in expanding war production. The firm which, at the behest of the Government, undertakes to double, triple, or quadruple, its normal output is allowed, in addition to its average-earnings base, only 8% of its net equity capital additions through sale of stock. This in effect usually means that the more war production is expanded, the more closely the excess profits credit approaches the 8% return allowed on additional capital.[22] Although an assured return of 8% for the postwar as well as the war years might be sufficient to attract new equity capital into these expanding enterprises, the high degree of uncertainty with respect to the postwar position of these firms makes them relatively unattractive outlets for investment funds. Consequently, the high effective rates of taxation to which many such firms are subjected not only prevent them from financing their working capital needs out of profits, but also serve to deprive them of new working capital from private sources.[23] This

[20] Many corporations, as evidenced by their 1942 financial statements, are substantially discounting current earnings by setting up contingency reserves. These reserves are not deductible from taxable income.

[21] See p. 124, *supra*.

[22] Corporations with invested capital of less than $5 million may find it to their advantage to use the invested-capital method of computing the excess profits credit which allows such corporations a credit of 8% on old and 10% on new equity capital.

[23] To the extent that the requirements for increased production take the form of new plants and equipment, recovery of the investment in such plant is facilitated by the five-year amortization provisions enacted in the Second Revenue Act of 1940. These provisions, however, do not extend to working capital, and it is largely with respect to this type of capital that the small firms face particular embarrassment.

financial problem is especially critical in the case of small firms with low excess profits credits.

Thus, growing firms are confronted with the alternative of expanding operations less rapidly than is desired by the Government, or of obtaining funds from Government sources. Through its various agencies, the Government does stand ready to finance both the fixed-capital and working-capital requirements of firms engaged in filling war contracts. The Reconstruction Finance Corporation makes direct loans to such firms on the security of the contracts. In addition, the military establishment makes advances on war contracts, and subcontracts. The military establishment may also guarantee loans made by banks and other lending institutions to war contractors —the so-called "V-Loan."

It appears, however, that government assistance in financing working-capital requirements has not altogether overcome the financial difficulties of small expanding corporations. Complaints are still made that the high effective rates of taxation to which these firms are subject are interfering with the potential expansion of the war-production program. Consequently, it can be said that the financial difficulties attributable in part to high war taxes threaten at some points to prevent the attainment of maximum output.[24]

The tax law does make allowances for unusual risks associated with attempts to increase the production of much-needed war materials under certain special circumstances. In order to encourage the production of the so-called "strategic minerals," complete exemption from excess profits taxes has been given to profits from the production of twelve minerals, most of them not ordinarily produced in the United States.[25]

Another special case in which excess profits taxes may inhibit production if excess profits are inaccurately defined is to be found in the case of certain mining properties.[26] The amount of income which most operators can ultimately derive from such properties is limited by the extent of ore reserves. Whereas the acceleration of production during the war years need have no effect upon postwar operations of nonmining enterprises, the greater the increase in mine output during the war, the smaller will be the potential output in postwar years. Therefore, if the acceleration of output subjects mining operators to excess profits taxation, they may have an inducement to limit output during the war.

However, the acceleration of output need not always mean that the owners of mineral resources will be unreasonably burdened by heavy taxes on income bunched in the war years. The severity of the hardships imposed will, in general, depend upon the extent to which accelerated output during the war will actually reduce postwar profits. If the additional output is small relative to the total reserves in the property,

[24] This conclusion is based on views expressed by small businessmen engaged in production under war contracts.

[25] Revenue Act of 1942, §226.

[26] A similar situation is found in the case of timber properties, although for certain types of timber stands more or less continuous operations are possible.

no great sacrifice is imposed on the operator who is forced to accept a low profit margin on ore which would not have been mined for at least 20 or 30 years. Even if a profit at the end of that time was assured, its present value would be small. Moreover, the extraordinary demand for certain minerals during the war may afford some owners of mineral resources an opportunity to recover assets which they would have little or no chance to recover under normal circumstances. Many marginal ore deposits are now being worked which will have little value to their owners once foreign sources of supply are again opened up.

This special situation of the operators of certain mining and timber properties was recognized in the Revenue Act of 1942,[27] and relief from excess profits taxes was afforded to such operators with respect to income attributable to accelerated output. Operators are, however, given full relief from excess profits taxes on income attributable to their increased output only in those cases where such output represents a high percentage of remaining reserves.

III

The conclusions of this analysis can be summarized briefly. In the first place, the excess profits tax in wartime has certain limited effects on the cost of production. Similar effects do not result from the corporation income tax. In the second place, wartime corporation taxes exercise some direct influence on the price level; they tend to relax, somewhat, the severity with which prices are regulated. This price effect is in addition to that resulting from increased costs. In the third place, wartime corporation taxes have held 1942 dividends as compared with net income after taxes at least to the average relationship between income and dividends from the years 1933 through 1941. In general, the financial strength of corporations does not appear to have been impaired. And finally, excess profits taxes, in some cases, have increased the financial problems of some firms and thus prevented the full attainment of potential output.

[27] §209.