In recent years there has been an increasing disposition to question the wisdom of taxing business or of laying taxes upon the business unit. This questioning is not a mere product of the irritation that accompanies tax paying. Reasons, or at least arguments, are given which command attention. If property is taxed and income is taxed, we are asked, why mess up the simplicity of the system by a further tax on enterprise, a penalty on initiative and thrift, a damper on industry? The attempt to tax business, the critics proceed to say, has complicated the property tax and marred the income tax; it has inspired attempts to measure the halo with which live business invests dead assets and to assess property more when it is owned by a successful business concern than when it is owned by an unsuccessful concern; it sets the tax-gatherer on a hunt for good will and intangibles; it has generated a brood of “franchise taxes” which are inconsistent, illogical, and selfish; it corrupts the income tax, giving rise to indefensible exhibitions of double taxation in which the state or the nation taxes income both where it originates and where it is received; and, finally, it is shifted when it was not expected to move, or perversely remains “put” on other occasions when it was confidently expected to move along to the ultimate burden-bearer.

Worst of all, the criticism continues, taxation on the business unit violates the principle of ability to pay. Take two corporations with precisely the same capital, business, and net income. One is owned by a large number of small shareholders, mechanics and workingmen perhaps. The other is owned by a few rich men. A given tax upon the first corporation will not have the same effect upon its shareholders as an equal tax would have upon the shareholders of the second corporation. Large corporations are frequently owned by
small shareholders, and small corporations are frequently owned by wealthy shareholders. It follows, therefore, according to the critics, that in imposing taxes, particularly income taxes, we should avoid the intermediary, the go-between, the business agent, and lay the taxes directly upon the individual shareholders. Only thus, it is asserted, shall we avoid conflict with the great principle of ability to pay.

This, in crude form, is the case against the business tax. In attempting to consider it, limitations of space and other obvious reasons make it necessary to confine the discussion practically to taxes on mercantile, manufacturing, and miscellaneous competitive business concerns. We must put to one side and ignore punitive taxes, sumptuary taxes consciously designed to repress certain industries, taxes on monopolies and trusts imposed in the hope of recovering for the public some of the gains wrongfully wrung from the public, and quasi-rental charges employed to measure the privileges conferred by the state upon some corporations. These are special business taxes for which there is, or is supposed to be, special justification. For somewhat different reasons, the conclusions reached in this paper are also inapplicable to railroads and many other public service corporations, with respect to which the land tax and the business tax are inextricably interwoven. It seems desirable to add, also, that I express merely personal opinions which, for the most part, I have held for a number of years.

The strongest reason for the retention and perfection of business taxation is found in experience and fiscal history. Business taxes are as old as organized business. They are all but universal throughout the world and show no tendency to disappear with the passage of time. We have hundreds of them in the United States. Frequently with us the necessity of taxing business is not frankly acknowledged, and all sorts of indirect efforts are made to accomplish the same end under the guise of so-called franchise taxes, incorporation fees, corporate excess taxes, and the like. These are in reality forms of business taxation and, in my opinion, we shall never have
even an approximately consistent scheme of taxation until the necessity for separate business taxation is recognized and imposts laid which are consciously designed to express the fiscal obligations of business as such.

From political and moral standpoints, the justification for this great class of taxes is plain. A large part of the cost of government is traceable to the necessity of maintaining a suitable business environment. Historically, some writers maintain, the city has been evolved for the very purpose of fulfilling this function. Business is responsible for much of the work which occupies the courts, the police, the fire department, the army, and the navy. New business creates new tasks, entails further public expense. A small amount of new business may not show its influence at once upon public expenditures. The relationship between private business and the cost of the government is a loose one, much like the relationship between the expenses of a railroad and the amount of traffic which it carries. The connection, however, is real and, in the long run, the more business the greater will be certain fundamental costs of government. The industry which does not pay its due share of public expense is generally a source of weakness and not a source of strength. Surveyed from one point of view, business ought to be taxed because it costs money to maintain a market and those costs should in some way be distributed over all the beneficiaries of that market. Looking at the same question from another viewpoint, a market is a valuable asset to the social group which maintains it and communities ought to charge for the use of community assets.

Finally, taxes upon business have great fiscal virtue as such. They are relatively inexpensive to collect and comparatively productive in yield. A given rate of taxation laid upon the business unit will usually yield a very much larger revenue than the same rate of taxation laid upon the individual owners of the business.

II

Is not this fiscal obligation of business adequately met by the property tax and the personal income tax?
I think not. So far as the property tax rests on land it has a peculiar justification, dependent principally upon the important phenomenon usually described as the capitalization or amortization of taxes. In the case of mercantile business, to be sure, the rental value of the real estate which it uses is closely connected with the fiscal obligation under discussion. But most of this rental value is paid to private owners and, as has just been suggested, the whole situation is complicated by the amortization of land taxes. Moreover, in the case of factories and other miscellaneous business concerns there is no helpful relationship between the rental value of the real estate occupied and the duty which the business in question bears to the state. And so far as personal property is concerned it is obvious that the amount of property which a man owns or uses at a given place has no helpful or necessary relationship either to the expense which his business causes to the government or to the success with which he is able to exploit the commercial possibilities of that place.

In the taxation of a process so elastic and mobile as business, there is necessarily present an element of the *quid pro quo*. You cannot charge for access to the market in the long run more than such access is worth. It is for this reason you cannot successfully or logically measure the business tax by property. There may be much property with little business or much business with little property. You can make shift, poor shift, with a property tax for this purpose, if you will abandon the uniform rate, make all sorts of dickers with different classes of business, create franchises where there are no franchises, and manufacture with your fiscal imagination all sorts of intangible property based upon business, giving this intangible property a flickering, uncertain situs where the business is transacted. This is business taxation, but poor business taxation. Fortunately, however, we have already come to recognize this truth. Whether there should be any tax on business at all is a fair question for debate; but, granting the necessity for such taxation, few people will now seriously defend a tax on property as a fair measure of the duty devolving upon business as such to support the state.

For similar reasons the personal income tax is plainly un-
fitted to express the fiscal obligation in question. That tax is supposed to be paid where a man resides, not where he transacts business. Here is a corporation whose owners live in jurisdiction A, whose factory is in jurisdiction B, whose main offices are in jurisdiction C, and whose principal sales department is in jurisdiction D. It needs no discussion to prove that each of these jurisdictions will demand and in the long run will succeed in collecting some tax, although the personal income tax would ordinarily be collected in only two of these jurisdictions, and many advocates of the income tax would confine the collection to jurisdiction A, in which the individual owners reside.

III

So much for the general philosophy of business taxation. In what form would it adapt itself most successfully to the general structure of the American system of taxation?

Much in this connection can be said for a tax upon gross business. The supporting arguments in this connection are familiar: such a tax is not inquisitorial; it does not raise difficult questions about losses, depreciation and the like; it is more easily allocated among competing jurisdictions than a tax upon net income. Perhaps the most severely logical form of business taxation would be one upon gross business at different rates for the various classes of trade and industry, which rates were themselves determined by the normal or average relationship between net income and gross business in each class of trade or industry. I speak of this as “perhaps the most severely logical form of business taxation” because there is in business taxation a harsh element of quid pro quo which tempers the milder element of ability to pay. In imposing such a tax the government would say in effect to the business man: “You have come amongst us and have exploited our market; you have trafficked as much as your competitor; whether you have used your opportunity as well as he is not our concern. It is the gross volume of your trade which both represents your opportunity and causes our expense. Upon that you must pay.”

I have no particular quarrel with that philosophy, but an-
other philosophy impresses me as being grounded upon a deeper truth and likely to prove in practice more successful. I like better the deeper insight of shrewd old Adam Smith, who in the first of his famous canons harmonized the benefit and ability principles in words which, have been often quoted:

“The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation.”

There is no perfect measure of any tax. Net income is not a perfect measure. But it is a better measure than gross income. It encourages the infant industry. It spares every industry in the lean years. It fosters industrial experimentation. In practice it saves the legislature the invidious task of classifying the various rates that must be adopted if the tax is laid upon gross income or gross business. I have had some experience with a highly classified business tax. I have no hesitation in stating that the legislative task of differentiating the rates, together with the subsequent administrative task of locating each industry in its proper place, raises more and more difficult problems than are raised by the net income tax. In the long run the net income tax is the simpler; it wears better. Moreover, classified business taxes almost always look up to the net income tax as their final goal and approach it more closely year by year.

The tax should not only be upon net income, but the rates should be graduated. It is difficult to obtain a sound basis for the graduation of income taxes imposed upon business units. This is a problem which has long worried thoughtful students of taxation. The solution, there is some reason to believe, has now been found—not the exact solution but an approximate one. I refer to the excess profits tax which, first adopted a year or two ago, has now spread to 14 or 15 countries and is yielding handsome revenues in most of them. A light tax
should perhaps be imposed upon the net income of all concerns. But the heavier rates and the heavier taxes should be imposed upon those concerns which are abnormally prosperous. The American excess profits tax is essentially a graduated supertax upon the net income of business concerns, and it has been so described by Senator Simmons, Representative Cordell Hull, and other members of Congress.

It is no accident, I believe, that after months of the most earnest investigation Congress determined by a large majority to adopt an excess profits tax rather than a war profits tax. This decision registered a deliberate judgment of Congress. It means, in all probability, that the excess profits tax has come to stay. For observe this difference: If we measure the excess to be taxed as the difference between income during the war and income just before the war, the tax is essentially temporary. The basis would become more illogical with each passing year, and the tax would be likely to disappear with the war which created it. But if we succeed, approximately, in determining what is the normal income and lay the tax upon the net income in excess of that normal return, we have a tax that may permanently endure. It represents, as it were, the share of the state in the “supernormal” success of every business enterprise. It measures roughly the value of the facilities, opportunities, and environment offered by the community. While I express no settled conclusion on this point, it seems to me exceedingly probable at the present time that the excess profits tax will continue as a permanent part of the American tax system. It will be, so far as the federal government is concerned, its expression of a graduated net income tax upon business.

At this point it is convenient to notice the fundamental criticism that taxes imposed upon the business unit do not conform to the principle of ability to pay.

As I have stated in another place, it is a shallow and narrow interpretation of the ability principle that tests its every application by the effect of the tax upon the consumer; which surveys man, the taxpayer, only as one who clothes his back and feeds his body. There are many valid varieties of the ability principle and among them are those which survey the
taxpayer in his capacity as producer, which take the business man in his economic and political environment, which recognize the truth that the state and community stand as silent partners in every business enterprise, which make a permanent place in our revenue system for a tax designed to take for the community a fair portion of all profits in excess of the amount required to elicit the requisite investment of capital.

Most good business taxes combine or represent at once both the ability and the benefit principles. The English income and excess profits taxes represent, according to the English courts, shares of the state in the profits of private business; and the similar American taxes so far as they apply to business concerns apparently partake of the same character. These are not taxes upon the individual, to be judged by the sacrifices which they impose upon him, but the prior claim of the state upon the private profits which public expenditures or the business environment maintained by the state have in part produced. The government’s claim to part of the profits, particularly in time of war, is so strong as almost to justify the statement that the stockholders have no claim on the profits until the government has released them. When a special assessment or betterment tax is imposed, no cognizance is taken of the individual’s ability to pay. For much the same reason, when an excess profits tax is levied upon a corporation or partnership no cognizance need be taken of the taxpaying ability of the shareholders. And yet business taxes are not antagonistic to the ability principle; they recognize, like the betterment tax and the inheritance tax, a species of ability to pay created by the activities of the state or by a “conjuncture” afforded by the community. The state or the community creates, as it were, the fund from which the tax is taken. Moreover, business concerns do possess an organic unity; they are, when compared with one another, less able or more able to pay; the ability standard does apply to them as corporate or business entities.

IV

The tax upon the net income of business here proposed must be clearly distinguished from the personal income tax.
It is most distinctly not a mere method of collecting the personal income tax at source. The personal income tax is laid upon the individual in his capacity of consumer, and is paid where he resides whereas the business income tax is paid by men in their productive or commercial capacity at the place where the income is earned. While it could and should exist side by side with the personal income tax, it would reveal many sharp differences. It would insist strictly upon the taxation of salaries, rentals, and interest at source. It would employ, as has been pointed out, an entirely different principle of graduation. It is allied in nature to the group of taxes in rem rather than to those in personam.

We should not, of course, push the idea to extremes. It would be undesirable, and in this country unconstitutional, to attempt to tax the profit on each casual sale at the place where it is made. But we may legitimately levy some tax upon each unit of organization, upon each established department of a business. This raises the difficult problem of allocation, but that is a problem which arises in the application of every tax imposed upon the income or capital of concerns doing business in more than one jurisdiction. As a practical method of allocation the best rule yet suggested, in my opinion, is to compute the net income of a business establishment as a unit and then distribute the net income in accordance with the property and “pay roll” of the business. A part of the net income, equal, say, to six per cent upon the net assets, may be distributed in accordance with the location of the physical properties. This is, as it were, a fair return upon the investment, which must be recognized before the more elusive elements of business are taken into consideration. Thereafter the business factors proper—the business of production, of marketing, of sale, and even of buying—may be roughly but fairly recognized by an apportionment in accordance with the expenditures for salaries and wages. These expenditures allocate themselves naturally and they measure perhaps better than any other simple standard the importance of the pure business-factors.

This method of apportionment is merely a rule of thumb. Eventually the difficult problem of allocation will have to be
solved more scientifically. What is most needed is a uniform rule. Just what rule shall be selected is less important than the general adoption of the same rule by competing jurisdictions. Eventually the federal government (through the Interstate Commerce Commission or the Federal Trade Commission or both) should lay down general rules for this important department of American business. An equally efficacious remedy would be found in the adoption of some common rule by the Congress of States whose organization has just been effected; or by the passage, voluntarily, of uniform legislation upon this subject by the several state legislatures.

V

What should be the relation between the business tax and the general property tax? This is a far more difficult question and depends upon our interpretation of the meaning and future of the personal property tax. In my own opinion, the business tax should take the place of the tax upon the personal property of business concerns. But I arrive at this conclusion merely because, so far as I can see, the personal property tax has no rationale and no future. It has no pride of ancestry and no hope of posterity. It is at present merely a haphazard, unscientific, inequitable method of raising revenue. It is at once without scientific foundation and without large administrative virtues. I look forward to a system composed of a tax upon real estate, a personal income tax, and a tax upon the net income of business; augmented, of course, by inheritance taxes, sumptuary taxes, and other collateral revenues based upon miscellaneous but tenable grounds.

It is possible that the tax upon personal property might be perfected and placed upon a logical basis. In this event it would come to serve the general purpose for which the “supplementary tax” was introduced in Germany. A tax of this character upon capital or net assets might fill a useful and legitimate place. But for practical reasons it seems impossible to place the American property tax on this basis; and even if so sweeping a reform were effected, it would still leave place for the business tax of which we have been speaking.