

(The information referred to follows:)

[From Harvard Business Review, July-August 1967]

THINKING AHEAD—TAX SPEEDUPS AND CORPORATE LIQUIDITY, BY JOSEPH E. MILES

Acceleration of corporate income tax, Social Security, and employee withholding payments is squeezing business

FOREWORD

U.S. corporations have exhaustively examined the implications of the changes that have been made in their tax rates and base and in provisions for writing off capital investments. But they have paid too little attention, the author says, to the present and potential effects of the acceleration of tax payments which President Kennedy began and President Johnson is continuing. Dr. Miles is Vice President and Investment Counselor of Lionel D. Edie & Company, a New York investment and economic consulting firm, and is a member of the New York bar.

Acceleration of various direct federal taxes will provide an estimated increase in revenue of \$22 billion to \$23 billion when it is completed. Additionally, Social Security taxes have been increased about \$6.5 billion in the last two years, and even larger increases are in the offing. The impact of some of these tax changes is fairly certain; others are uncertain and conjectural at this point. Some will dampen the economy; others will stimulate it.

One thing is apparent: it isn't the same world as before, and thinking will have to change. This tax speedup has had and will continue to have an important effect on the structure of the business environment, including corporate cash flow, competition, customers' purchasing habits, the level and life of receivables, and the level of demand.

Yet, because structural changes do not lend themselves to normal business forecasting or corporate routines, many of these tax-induced changes have not been anticipated by corporate executives.

This analysis concerns itself primarily with the changes in payment dates on certain taxes and the several increases in Social Security tax rates. (The businessman presumably is familiar with the highly advertised reductions in tax rates for individuals and corporations in 1964 and 1965, the indirect corporate tax reductions represented by shortened depreciable lines in 1962, and the 7% investment credit instituted first in 1962.) I shall stress the substance of these changes and not the form in which they were passed by Congress or have been proposed by the Administration.

The conclusions stated herein are made with the proviso "all other things being equal." This is done not to protect me from bearing the weight of my errors but to underscore the probability that these results will give rise to offsetting or softening federal legislation.

Changes in the tax rates and tax base are understood rather easily. More difficult to grasp is the speedup of payments. President Johnson accelerated the payment dates on a number of taxes without changing rates. The attitude of many persons, including many corporate officers, to acceleration has been: We owe it anyway, we pay it a little earlier, so what?

For a better understanding of acceleration, let us examine an extreme case. Assume that all taxes are due on December 31 of each year. Then they are accelerated and become payable January 1. There is no increase in the rates; the same amount of taxes are due and paid in each year. But only the naive would say that to pay 100% of all taxes for two years in two days is not an increase. Acceleration is in effect a temporary tax increase during the period of speedup.

One failing of those who do not view acceleration as a temporary tax increase is that they misunderstand two accounting terms, namely, *reserved* and *funded*. Consider federal corporate income taxes. A tax liability arises whenever a corporation shows a profit. Before acceleration, payment of this liability lagged an average of seven to eight months behind the period in which it arose. A corporation generally did not put money aside to pay taxes as the tax liability was incurred. True, the amount of the liability was *reserved* on its books, but it was not *funded*. Taxes were paid—and still are paid—from current cash flow and current profits, and not from yesterday's cash and profits.