

Those corporations that attempt to pay the accelerated taxes from cash flow will lose competitive position, especially if they tighten inventories and receivables.

The tax speedup has squeezed, and will continue to squeeze, profit margins and per-share earnings. Corporations funding these liabilities find that overhead costs are higher, reflecting the carrying charges of the debt—which is not backed by an earning asset. To some extent corporations have been forced to pay higher interest rates because funding of taxes has caused their credit rating to deteriorate. Funding of accelerated taxes with common stock directly reduces per-share earnings.

LIKELY IMPLICATIONS

Acceleration of the various corporate taxes will add up to \$20 billion by the time the proposed round is over. This total consists of: the JFK round through 1967, \$7 billion; the LBJ acceleration of corporate income taxes in 1966–1967, \$5 billion; acceleration of withholding and Social Security taxes, \$2 billion; and the proposed acceleration of corporate income taxes, \$6.5 billion.

The consequences of funding obligations are not the only effects on businesses. There are others, some of a short-run nature and some more far-reaching.

Who will pay

The burden has fallen and will continue to rest almost entirely on larger corporations. Naturally, they must pay their own accelerations. Also they will have to carry part of the acceleration burden of smaller—especially privately owned—corporations, which usually have a difficult time raising money.

The tax speedups eventually will take upwards of an additional \$4 billion from the smaller companies. They do not have it and will “borrow” it from larger corporations by paying their bills more slowly, demanding more credit and longer terms, and requiring the larger corporations to carry their inventories. The larger companies' accounts receivables will rise. Those companies that will not or cannot grant more liberal credit terms will be at a competitive disadvantage.

Medium-sized companies

The per-share earnings growth of medium-sized companies will probably slow down. The burden of their own accelerated tax payments, as well as the indirect assumption of the burden of smaller companies, will force them to raise capital. Considering their size and the nature of the securities markets, financings on their part are likely to be either convertible debentures or common stock.

In either event, future earnings growth will be diluted on a per-share basis, leading to slower market appreciation of the stock and erosion in price/earnings multiples.

The slowdown in 1967 profits

Although a slowdown in corporate profits in 1967 is reducing the total tax bill, it is squeezing cash positions even more. The greater the drop in profits, the higher the corporate cash tax rate and the more the squeeze. An approximation of the impact can be obtained by reading *Exhibit I* from right to left. For a company whose earnings growth is declining from 10% in 1966 to zero in 1967, the cash tax rate increases from 49.13% to 51.60%.

Further funding

Although corporate tax acceleration will drop from an estimated \$6.5 billion in 1967 to \$2.6 billion in 1968 and \$1.4 billion in 1969, the tax-induced incremental demand for funds will still remain at a high level. Funding of this additional amount, plus \$800 million per annum in 1970–1972, will continue to exert some pressure on the money and bond markets.

Corporate cash flow

I have pointed out that acceleration is equivalent to a temporary tax increase. One of the proposed speedups, the increase in payments of estimated taxes from 70% to 80%, is a permanent one. The resulting tax increase, however, will offset only a small part of the eventual decline in the cash tax rate, as can be seen in *Exhibit II*.

The exhibit draws comparisons with 1963, the last year before reductions in the tax rate and acceleration. A 5% margin for error is included in each estimate.

After acceleration is completed, the reduction in the corporate tax rate reduces actual corporate income tax payments by an estimated \$2.4 billion a year (assuming a 5% growth rate in pretax profits). Raising the estimated payments from 70% to 80% reinstates \$200 million of the cut.