

EXHIBIT II.—EFFECT OF INCREASING ESTIMATED TAX PAYMENTS

(In percent)

	Zone growth	5 percent growth	10 percent growth	15 percent growth
1963.....	52.00	50.45	49.05	47.76
75 percent estimate.....	48.00	47.74	46.91	46.43
85 percent estimate.....	48.00	47.66	47.35	47.06

The increase in estimated payments from 70% to 80% primarily affects large corporations. One might suppose that with lower cash tax payments eventually, the burden on the large companies of indirectly carrying the tax acceleration for the small companies is short-lived. This is not true, however. The cash tax rate will not decline until 1970—and not until 1971 if the Administration should increase the minimum on payment of estimated corporate taxes to 90% (which is a real possibility).

Furthermore, companies that have about \$1,000,000 of pretax income also will feel acceleration of payments on the first \$100,000 of their tax liability directly. For a company that size, such a speedup is equivalent to an increase in the tax rates of 1.5% during the period of acceleration.

Standby credit

Corporations will depend on banks for lines of credit to a greater extent than in the past. They must do this, or keep a larger cash balance against contingencies, for several reasons.

Almost all corporate income taxes will be due at the time the liability is incurred. Heretofore, when taxes were due 6 to 15 months after the liability arose, it was easier to predict requirements. Predicting the next quarter's earnings is often most difficult; and, with the minimum amount due rising from 70% to at least 80%, there would be even less leeway for error in estimated earnings.

More important, because future acceleration will squeeze the smaller corporations more and more, forcing greater assumption of receivables and inventories by larger corporations, the latter must bear much of the burden of periodic disruptions in the manufacturing process no matter where they develop. Since many of these problems cannot be forecast in advance, standby bank credit is the easiest and least expensive way to guard against such contingencies.

With corporate income tax payments more current, federal fiscal and monetary action should have a more immediate effect on corporate behavior during cyclical upswings. If greater use of bank credit develops, the monetary authorities will be in an even stronger position to dampen excesses or spur lagging demand for bank loans.

Mergers on rise

Mergers will be more frequent in the future, especially those involving smaller companies. These companies have felt only one round of acceleration—that on withholding and Social Security. The really big one will start January 1, 1968. As they feel this squeeze, and when they cannot borrow, they will be more inclined to sell out. Smaller utility and telephone companies will be particularly vulnerable.

Medium-sized companies will also be squeezed. Those that are not financially strong enough to absorb the burden of higher inventories and receivables forced on them by the effect of acceleration on smaller companies will either lose position or merge.

Shift in tax payments

Before the speedups, larger corporations paid 62% or 63% of their income tax bills in the first half of the year. The JFK and LBJ rounds of acceleration were concentrated in the first half of the year, increasing the percentage of the tax bill paid by larger corporations in the first half to about 66% in 1967.

With the completion of these speedups and the proposed increase in payment of estimated taxes, however, larger corporations will be paying about 57.5% of their tax bill in the first half and 42.5% in the second half. (Smaller corporations were paying upwards of 100% of their tax bill in the first half; by 1972 they too will be paying 57.5% in the first half and 42.5% in the second half.)

This means that corporations will borrow more in the second half of the year (specifically, on September 15 and December 15) and less in the first half than they did before.