

Cyclical companies

A corporation whose operations are cyclical will not be as financially pinched during business declines as it was in the past, because of the lag in tax payments. The decrease in the rates will also alleviate the cash squeeze. Prior to 1964 a downturn in pretax profits of 15% increased the cash tax rate to 57.7% in the year of the profit decline. After acceleration is over, a 15% downturn will result in a 49.3% cash tax rate.

Conversely, during an upswing a cyclical company will not be able to use the lag in tax payments to finance itself as readily as it did in the past. If a company had been in a zero growth period and then registered a 15% increase in pretax earnings, its cash tax rate would have declined from 52.00% to 47.76% prior to acceleration. After acceleration, however, the same circumstances will cause a decline in the cash tax rate from 48.00% to 47.06%.

Growth companies

The faster the growth in earnings enjoyed by a company, the less the decline in cash tax rate accomplished by the cut in rates and acceleration. The cash tax rate will decline from 52.00% to 48.00% for a zero growth company, from 50.45% to 47.66% for a 5% growth company, and from 47.76% to 47.06% for a company with a 15% growth rate.

Furthermore, the speedup of corporate income tax payments imposes a greater incremental tax burden on the company with faster growth. For example, under the JFK round the average cash tax rate over the period of acceleration declined from 52.00% to 51.21% for a zero growth company and increased from 47.76% to 48.15% for a 15% growth company. The LBJ round was again more oppressive on faster growing companies.

An increase in payment of estimated taxes to 90% will offset virtually the entire remaining reduction in cash tax rate for the 15% growth company.

Local governments

State and municipal governments have discovered the advantages of acceleration. Several government units have upped their tax take in this way—New York State and New York City, to name two—and others probably will follow.

EFFECTS ON TAXPAYERS

Senior management of a company, and especially marketing executives, should be aware of changes in the consumer's federal tax burden and in his "cash flow" as affected by withholding.

Social Security

Increases in both the rate and the base for Social Security taxes took place in 1966. Assuming the about half the estimated \$6 billion boost effective then was paid by employees, \$3 billion was removed from their disposable income. To this should be added the \$300 million acceleration of Social Security taxes assessed in 1966 against self-employed individuals.

During 1966 Social Security benefit payments increased by \$4.8 billion. The net effect was an increase in disposable income of \$1.5 billion. The groups paying more and the groups receiving more do not have the same consumption mix, however, and the effect on a particular company varies according to the markets it serves.

The Administration has proposed increases in both Social Security benefits and taxes. As of this writing it is impossible to say exactly what the changes will be; but for the purposes of this analysis, I have assumed that the increases will be enacted as proposed. Even if they are not, the trend is evident, and sooner or later the package will be passed in some similar form.

Increased benefits became effective July 1, 1967; increased rates will be imposed on July 1, 1968. Thus there is a "plus" effect this year and a "minus" effect next year.

Social Security tax payments will go up in 1968, 1969, 1971, 1973, and 1974 (with minor increases thereafter). The rises will have different effects. The 1968, 1971, and 1974 boosts are in the base: in 1968, from \$6,600 to \$7,800; in 1971, to \$9,000; and in 1974, to \$10,800. The 1969 and 1973 increases are in the rate, from 4.4% to 5%, and then to 5.55%. The rate increases are the more regressive.

We will experience a number of step-ups in rates and base over the next eight years. All will have adverse impacts upon spending—how much depends on whether the increase is in the rate or the base. Granted, there will also be step-ups in benefits, but they will come largely in different time periods.