BOOK REVIEWS

Effects of Taxation: Inventory Accounting and Policies. By J. Keith Butters. Boston: Harvard University Press, 1949. Pp. xix, 330. $3.75.

Effects of Taxation: Corporate Mergers. By J. Keith Butters, John Lintner, William L. Cary. Boston: Harvard University Press, 1951. Pp. xviii, 364. $4.25.

Effects of Taxation: Executive Compensation and Retirement Plans. By Challis A. Hall, Jr. Boston: Harvard University Press, 1951. Pp. xv, 365. $4.25.

Effects of Taxation on Executives. By Thomas H. Sanders. Boston: Harvard University Press, 1951. Pp. xiii, 229. $3.25.

Although tremendous business segments are conducted by unincorporated organizations, the history of American business during the past half century is inseparable from the history of corporate activity. Thus, when the Harvard Graduate School of Business Administration undertook, several years ago, to sponsor a comprehensive survey of the effects of federal taxation on business, the studies were confined, almost exclusively, to corporate enterprise. Acting under a grant from the Merrill Foundation for Advancement of Financial Knowledge, Harvard planned a series of eight volumes, four of which are reviewed here.

In the first volume, Professor Butters has focussed attention on the role that tax factors play in determining management's inventory policies. He demonstrates that management's response to this problem lies, at least partially, in the increasing use of the Lifo (last-in-first-out) method of valuing inventories, as contrasted with traditional Fifo (first-in-first-out). However, although Congress has made Lifo available to all businesses, as of 1949 this method had been used in connection with only one-seventh of manufacturing inventories. Among other segments of American business, only the department stores make substantial use of this system.

In contrast to Fifo, Lifo generally results in lower income taxes during a period of rising prices. Correlatively, however, Lifo results in higher taxes when prices decline. This factor, together with many non-tax considerations (including misplaced fear and even ignorance), have combined to restrict the use of Lifo. Thus, it is fair to assume that American business has only begun to exploit the tax savings inherent in this form of inventory accounting.

Inventory plays a significant role in corporate financing, over and beyond mere tax considerations. Professor Butters maintains that it would be socially

advantageous to devise a concept of taxable income that would eliminate the grotesque distortions which follow from a doctrinaire assumption that taxable income must vary according to inventory profits and losses. While Congress made a significant change in the concept of taxable income when it authorized Lifo, and also when it offered relief to Lifo users in the case of so-called involuntary liquidations of inventory, realization of Professor Butters' hope may have to await comprehensive overhauling of the entire federal income tax structure.

The second volume analyzes, in fascinating fashion, a number of misconceptions concerning the role which taxation plays in corporate mergers. The authors justifiably contend that the merger movement of the past 20 years has resulted in less concentration than earlier ones, and they predict that any future merger movements will follow this trend.

It has been contended that the increasingly heavy impact of federal taxation has necessitated the transfer to corporate form of many businesses owned by a family or other limited group. Most of the book is concerned with the various considerations which prompt transfers of business to new proprietors. Actual transfers which have had national publicity are analyzed, such as the sale of the Toni Company to Gillette Safety Razor Company and the merger of Allied Oil Company, Inc. with Ashland Oil and Refining Company. The role of the federal estate tax is discussed, with an interesting appraisal of the recent amendment involving the income tax aspects of stock redemption to pay death duties. Problems of liquidity and valuation of closely held corporations, as well as the interplay of the capital gains tax and the tax on unreasonable surplus accumulations, are reviewed with acumen.

The authors point out that the apparent alternatives to sale or merger, such as inter vivos gifts, public sale of stock and transfers of various kinds to philanthropic institutions are theoretically available, but in most cases do not, for many non-tax reasons, provide real alternatives.

In addition, Professor Cary has commented on the effect of taxation on the legal form of the business transfer. His analysis sets forth the highly complicated reorganization provisions of the Internal Revenue Code in easily understandable terms, and formulates the tax results which follow from the use of the various kinds of transactions.

Based on studies of actual mergers occurring during the ten-year period, 1940–1949, the authors conclude that substantially fewer business establishments have been, or are being, sold for purely tax reasons than is popularly thought. Nevertheless, it may well be that tax considerations constitute the principal reason for any particular sale. Yet, even when tax considerations predominate, the transfer might still have taken place, even in their absence.

Professors Butters, Lintner and Cary feel strongly that corporate mergers (in the generic sense) are merely one facet of the normal human drive for effecting business expansion. Also, personalities cannot be overlooked. Thus, the authors declare:

Another motive, seldom advanced as an explanation by participants but undoubtedly in the background of many transactions, is the effect of mergers on personal status of management. The prestige and earning power of management depend, among other things, on the size of the company operated. Actions which enlarge the company naturally tend to increase the power and prestige of its management. Business executives, being human beings, can be presumed not to be impervious to such considerations; "empire building" is not a disease to which only government officials are susceptible.[1]

The study on Corporate Mergers comes as a refreshing antidote to many of the pat formulae offered by the purveyors of tax panaceas. Too many of these formulae minimize non-tax considerations. However a sale is never ex parte. This study makes most clear how intricate and complex is the tug of war between those who buy and those who sell.

The third and fourth volumes by Professors Hall and Sanders, respectively, offer complementary analyses of the effects of taxation on executive compensation. Professor Hall describes the various types of corporation compensation plans and analyzes their relative tax advantages. He measures the effects on executives of large corporations of deferred compensation, non-qualified bonus, and qualified retirement plans. Lastly, Professor Hall discusses the economic effects of federal taxation and deferred compensation plans on the large corporation itself.

Indiscriminate use of deferred compensation plans poses a real threat to the progressive surtax theory of income taxation. The treasury has not been blind to the ramifications of their wholesale adoption. At present, there is considerable uncertainty whether many such plans effectively defer taxable income. Normally, the corporation wants a present deduction for amounts set aside to pay compensation at a later date. The executive hopes that his compensation will be taxable at a time when his income generally is much lower. A clash between the interests of the corporation and those of the executive often leads to stalemate. Presently, however, a combination of various factors has led to the adoption of more and more such plans.

Professor Hall observes that "the net effect of high progressive personal taxation in lengthening the years of active executive employment, reducing efficiency and efforts of executives indirectly (and perhaps directly) and impairing the allocation of executives among different companies is to reduce the output of goods and services."[2] On the other hand, the growth of qualified retirement plans tends to increase the production of goods and services. Such an opinion is, of course, based in large measure on the author's own judgment of the responses to his inquiries obtained in his field surveys. With that judgment there appears to be little occasion for dissent.

In contrast to Professor Hall, Professor Sanders' attention is focussed primarily on the motives and activities of the executive rather than those of his employer. He discusses such topics as the executive's daily routine, the mobility

[1] Butters, Lintner and Cary, Effects of Taxation: Corporate Mergers 21–22 (1951).

[2] Hall, Effects of Taxation: Executive Compensation and Retirement Plans 252 (1951).

of executive talent and the inducements for retirement. He also analyzes various types of direct compensation, stock options and stock purchase plans, expense allowances, retirement and pension plans and executive investments. Not unlike the authors of the other books, Professor Sanders maintains that there is great popular misconception of the effect of taxation on human activity. He also feels that while some people may retire earlier because of high income taxation, more executives work longer just because of such taxation.

Professor Sanders' book is well written, a luxury denied the reader of the other volumes. Nevertheless, his book affords less intellectual stimulation than the others and may be of less enduring value. Professor Sanders' book purports to be an analysis of what various executives told him were their own motives, a type of statistical investigation which is not always reliable.

Professor Sanders' analysis comes at a time when the old generation which knew relatively low taxes has not yet entirely passed from the scene and when the new generation which has known only higher taxes has not as yet matured. Granted that people will work hard for many objectives other than for the mere accumulation of money to be used for personal power or security, the continuance of high surtax rates does pose vital challenges to future top American management personnel.

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Compensating the Corporate Executive (rev. ed.). By George Thomas Washington and V. Henry Rothschild, 2nd. N.Y.: The Ronald Press Co., 1951. Pp. xiv, 586. $12.00.

In this day of high tax rates and increasing governmental control over the amount and manner of payment of compensation, this revised edition of Mr. Washington's *Corporate Executives' Compensation* (1942) is both timely and informative.

The revision, by Mr. Washington, presently Judge of the United States Court of Appeals, District of Columbia Circuit, and Mr. Rothschild, now Vice-Chairman of the Salary Stabilization Board, is a factual and objective study of the legal and business aspects of managerial rewards in the corporate field. The scope of the volume, greatly increased over the original edition, includes salary and profit-sharing contracts, stock bonus and stock purchase plans, stock options, pensions and deferred compensation plans.

Starting with a brief background of the development and philosophy of corporate executive compensation, the authors discuss, in varying degrees of detail, the form of the executive employment contract, the tax consequences of differing types of compensation, and the controls imposed on compensation by the federal government through renegotiation, cost limitations in government

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