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Corporate Regulation and the Origins of the Corporate Income Tax†

MARIORIE E. KORNHAUSER*

INTRODUCTION

Two of the major changes the United States experienced during the Progressive Era were the growth of large corporations and the acceptance of the income tax. This Article examines the intersection of these two changes at a point called the Corporate Excise Tax of 1909.1 The traditional view of this tax holds that the tax was primarily a political stepping stone toward the income tax, born of the struggle between pro and anti-income tax advocates and of the history of tax. It is perceived as a compromise at best, at worst as a barrier to the eventually triumphant income tax reform. This view is not wrong, it is simply incomplete. It is too narrow because it views the tax only in the context of one of the areas of change, taxation. The true significance of the tax appears only when it is placed at the intersection of both areas of change: taxation and corporate growth. So situated, the tax achieves its proper role as a corporate regulatory measure as well as the ancestor of the modern corporate tax.

The Corporate Excise Tax of 1909 reflects the Progressive Era’s attempts to regulate corporations in several ways. First, the tax debates themselves, as well as the law’s final form, reflected the era’s debates about theories of corporate legal personality, debates occasioned by the rapid growth of large, non-owner managed corporations. The decision to tax only corporations rather than certain specified businesses, no matter what form they were carried on under, was bolstered by an artificial entity theory of corporations which viewed corporations as entities separate from their shareholders.

Second, the tax reflected two popular tools of corporate regulation: federal incorporation and publicity. The tax was an alternative to federal incorporation proposals which were objected to on the grounds that they

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infringed upon state powers and expanded federal (especially executive branch) powers too much. These objections also arose in connection with the tax, but were milder since taxation was an acknowledged federal power. Thus, the tax provided an attractive alternative for a conservative President and Congress to the more radical incorporation proposals. The tool of publicity, or access to information, was a widely advocated method of curbing a variety of abuses. In an era when even the government, much less the general public, had little access to information about corporations, the publicity feature of the tax enabled the government to acquire information to help it legislate more knowledgeably, or, in the era’s jargon, more “scientifically,” in areas affecting corporations such as tariffs, antitrust and interstate commerce generally President Taft consistently supported the tax precisely because of the supervisory function provided by the publicity feature. The majority of commentary and debate about the tax also centered on this feature.

Third, and finally, the tax addressed one specific abuse of the era: stock watering or overcapitalization. Many people perceived overcapitalization as the source of trusts and as a danger to investors who were duped by stock watering schemes. The tax, serving as a form of securities regulation, addressed this problem in two ways. First, foreshadowing present day debates on curbing leveraged buyouts through the tax system, the law attempted to limit the use of debt by limiting the tax deduction for interest. The second method of attack was publicity of financial information (in the tax return) which theoretically enabled investors to avoid stock watering schemes.

This Article holds that the proposal, debate and passage of the Corporate Excise Tax of 1909 reflected not just a political deflection of the income tax, but also the deliberate use of tax law by President Taft and Congress for a non-tax purpose—corporate regulation. Part I of this Article briefly examines the vast corporate changes that occurred between 1890 and 1909 that affected the development of the Corporate Excise Tax. Part II summarily traces the history of the income tax up to 1909. Part III concentrates on the passage and content of the Corporate Excise Tax in relation to concerns about corporate power and abuse, particularly the publicity feature and, to a lesser extent, the interest, dividend and exemption provisions. Finally, this Article argues that an accurate view of the Corporate Excise Tax of 1909 places the tax in an historical context as part of two struggles: the attempt to enact an income tax and the struggle to regulate corporations. Viewed in this light the tax emerges as a nascent attempt at securities and corporate regulation as well as the source of our modern corporate income tax. While it was a moderate, cautious attempt at regulation by a conservative President, it was nevertheless a start.

The Corporate Excise Tax of 1909 is more than an historical footnote. Students of corporate and securities regulation will find that the tax adds
detail to their understanding of the areas. Students of taxation who look to the Corporate Excise Tax of 1909 will find not just the origins of today's tax, but a fuller understanding of the depths of the problems confronting us today in the debt and dividend areas, as well as in the issue of corporate integration itself.

I. CORPORATIONS AND THE PROGRESSIVE ERA

A. Introduction

The Progressive Era, roughly from 1890 to 1916, was a unique period of American history in which broad social and political reforms met and combined with a great change in our economic system: the rise of corporate capitalism. The transformation of capitalism from a system of owner/manager enterprises operating in a largely unregulated competitive market to a system dominated by a relatively few large, mostly non-owner managed corporations in a regulated competitive market was a pivotal change. This change affected, and was affected by, changes in other aspects of society including politics, law, the role of government, relations among classes, education and social thought. The Corporate Excise Tax was a product of


The years 1890 to 1916 seem to be the heart of the Progressive Era. In using them to define the period, I follow Martin Sklar. Obviously, these dates are not absolute; other authors mark the period differently, extending it at either end. Louis Galambos, for example, uses the years 1902 to 1914 to define the Progressive Era. L. GALAMBOS, supra, at 117.

3. Changes included the rapid growth of industrialization and urban life in America, and the growth of a large professional middle class whose expertise would rationalize and manage government, business and social reform. See generally R. WIEBE, THE SEARCH FOR ORDER, supra note 2; M. SKLAR, supra note 2, at 1-40. The many historians writing about this period have interpreted the data in various ways, seeing reform as issuing from any one or combination of the following sources: (1) the agrarian Midwest and South seeking a return to the somewhat mythic small farmer past, and the urban East and Midwest seeking to bring order and scientific professionalism to bear on the multitudinous problems of urbanization, immigration and the rapid growth of business, see, e.g., R. WIEBE, THE SEARCH FOR ORDER, supra note 2, at 166-71, (2) the small businessmen seeking to maintain their place in a world of large competitors, see, e.g., R. HOFSTADTER, supra note 2, at 217, and (3) the new professional middle class, id. at 218. Some historians saw progressive reform as mainly driven by Yankee-born Americans
corporate changes colliding with other changes. These other changes included the reexamination of the theory of legal personality, changes in federal governmental powers, shifts in federal-state relations, the rise of the income tax and the use of tax law to accomplish the non-revenue goal of regulating corporations.

Although the rise of large scale corporations preceded the Progressive Era,\(^4\) consolidation did not begin until the early 1890s. Rapid consolidation and merger started in 1898; by 1904, the wave of consolidation was basically over.\(^5\) This growth created dislocation problems for segments within the economic system (e.g., small businessmen) as well as for the system itself (e.g., cut-throat competition led to market gluts caused by overproduction).\(^6\) As a consequence, the mid-nineteenth century consensus concerning the free market began to break down. A new consensus requiring some regulation of the market was growing, but the quality and quantity of that regulation was not agreed upon since different groups wanted different things.\(^7\) By 1896 the problems created by the growth of large corporations and the concomitant issues of political, governmental and legal import, collectively the "trust" issue, had become the issue and would remain so until the end of this period.\(^8\) Although a complex issue, the problem, as commonly conceived by the general populace and legislators, was aptly presented in 1906 by Representative Martin of South Dakota:

Epitomized in few words, the trust is a combination of corporations.

Now, the evils of this new principle are very numerous, but the most serious and the ones deserving of our most immediate attention are, first, overcapitalization; second, the tendency to monopoly, and, third, the destruction of individual enterprise and success.\(^9\)

\(^4\) The rise began in the 1850s with the building of the railroads which reached their large, complex form in the 1880s. L. Galambos, supra note 2, at 6-7.

\(^5\) M. Sklar, supra note 2, at 45-46. Most of the consolidation occurred between 1898 and 1900, and from 1904 to 1954 little further concentration of industrial production occurred through corporate combinations. Id. at 46 (citing various studies).

\(^6\) Id. at 54-55.

\(^7\) M. Sklar, supra note 2, at 16-18. He states that this breakdown of consensus occurred by 1890. Id.

\(^8\) Id. at 24-26; see also R. Wiebe, Businessmen and Reform, supra note 2, at 43. Many of the sources listed, supra notes 2-3, deal extensively with the trust issue, as do other books, articles and textbooks. To list them all would add unacceptable length to this Article, but they run the gamut from the contemporary, A. Walker, History of the Sherman Law of the United States of America (1910), to the classic, H. Thorelli, The Federal Antitrust Policy (1954).

His solutions were just as typical: "[A]ny legislation that will be successful, must combine two or three principles at least. First, publicity; secondly, free competition; thirdly, close Federal supervision or regulation."\(^1\) Federal supervision was proper, Martin stated, because "[T]hese great aggregations of capital owe . their very existence to the operation of law. They are the creations of law, and they can be controlled by law "\(^1\)\(^1\) This characterization of the trust problem and its solution influenced the origins of the Corporate Excise Tax. In particular, the primary evil with which the tax dealt was overcapitalization (the evil often leading to other evils); the principles used by the tax were publicity and federal supervision (indirect methods often used to achieve the direct goal of free competition). Finally, the justification for the use of these two principles was a legal theory of corporate personality that emphasized the artificiality of the corporation. The remainder of Part I outlines the salient features of these two principles and the underlying legal theory justifying their use.

**B. Theories of Legal Personality**

As corporations evolved from a few specially chartered, specific purpose entities largely managed by owners to numerous large entities organized under general incorporation statutes and run by non-owners, the theory of corporations also evolved. During the Progressive Era, when the power and growth of corporations were at the center of public and political upheavals, the debates concerning the theory of corporate personality reached a frenzied zenith. Since both the general evolution of the theory of corporate personality and the course of debates at the turn of the century have been well-documented,\(^1\)\(^2\) only a summary is needed here. During the period from 1850 to 1880,\(^1\)\(^3\) general incorporation statutes gradually replaced the special grant statutes under which corporations had previously been formed. Under the grant theory corporations were viewed as fictional, artificial entities created

\(^{10}\) Id. at 1851.

\(^{11}\) Id.


\(^{13}\) Horwitz, *supra* note 12, at 323.
by the states with limited powers which were seen as privileges granted by the states. The demise of the grant theory took with it the artificial entity theory since, under general incorporation laws, it was the contract among individuals, not the power of the state, which created corporations.

The death of incorporation by special grant left a theoretical vacuum which was filled by animated discussion as to the nature of corporate personality. Thus, during the last quarter of the nineteenth century two alternative concepts gained credence: the aggregate and the natural entity theories, with the entity theory ultimately dominant. The aggregate theory, harking back to earlier in the century, focused on the contractual aspects of corporations and thus viewed the corporation as similar to a partnership. The corporation was simply an aggregate of its individual members, the stockholders. Under this model, certain rights of natural persons were extended to corporations (such as the right to equal protection under the fourteenth amendment in The Railroad Tax Cases) because this was the best way to protect the individuals. There were, however, two significant differences between a corporation and a partnership: shareholders normally had limited liability for corporate debts and, by this time, shareholders were merely passive investors, not involved in the management of the corporation. By the 1890s many commentators realized that an aggregate (partnership) view of corporations threatened the corporate privilege of limited liability.

14. See Hovenkamp, supra note 12, at 1597-1600 for a discussion of the associational view of corporations. Notice that the now fashionable economic theory of the firm also sees a corporation as simply a web of contracts. See, e.g., Fama & Jensen, Agency Problems and Residual Claims, 26 J.L. & Econ. 327 (1983); Jensen & Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976). See also the November 1989 issue of the Columbia Law Review which contains a symposium Contractual Freedom in Corporate Law which, while dealing with the issue of whether any corporate laws ought to be mandatory, discusses the contractual theory of the firm. 89 Colu. L. Rev 1395-1774 (1989). In particular, Hart, An Economist's Perspective on the Theory of the Firm, 89 Colum. L. Rev 1757 (1989) provides a succinct overview of the subject. A logical conclusion of this view of corporations is that a corporation should not be a separate taxable entity.


16. Although limited liability of shareholders existed, it was “far from the norm in America even as late as 1900.” Horwitz, supra note 12, at 350. “Double liability” statutes under which shareholders were liable for debts up to double their amount of unpaid capital were common in many states including New York. Id. In California, shareholders had proportionate liability for debts of the corporation under the 1879 California Constitution. CAL. Const. of 1879, art. XII, § 3 (repealed 1930). The California Constitution of 1849 provided similarly. CAL. Const. of 1849, art. IV, § 36. Both provisions are quoted in Blumberg, Limited Liability and Corporate Groups, 11 J. Corp. L. 573, 597 (1986). Blumberg states: “Limited liability is a statutory development that represents the triumph of the rising political power of business interests.” Id. at 576. Blumberg discusses the early history of limited liability in the United States at pages 587-95.

17 Horwitz, supra note 12, at 347
Unlike the aggregate theory, the real or natural entity theory of corporations held that the corporation was an entity separate from its members. However, this entity, unlike the artificial entity of the grant theory, was a real or natural entity or person with rights like any other person. The natural entity theory thus recognized the realities of corporate existence (e.g., limited liability, perpetual life and management separate from ownership). Unlike the grant theory, it recognized the reality of the power of corporations to act and the inability of the states to limit that power through doctrines such as ultra vires. Moreover, unlike the aggregate theory, it gave the legal system a basis to protect—rather than threaten—these features. By the turn of the century, corporations had many but not all of the rights of natural persons. However, the theory behind the rights was often a mixture of aggregate, fictional and entity theory.


[T]he doctrine of ultra vires breaks down when it is tested. It is not true because it fails to conform to the canon of scientific hypothesis: it does not fit the facts. We assume the artificiality of our corporation. We suppose that it is no more than we have made it, with the result that common sense must be thrown to the winds. What, in brief, the theory compels us to urge is this, that a class of acts may be performed by the corporation which are not corporate acts. Is it not better to risk a little for the sake of logic? Our fiction-theory may, indeed, break down; but we shall bring the law in closer harmony with the facts of life. We shall then say that the corporation, being a real entity, with a personality that is self-created, and not state-created, must bear the responsibility for its actions. Our state may, in the result, be a little less Hegelian, a little less sovereign in its right of delegation.

Laski, The Personality of Associations, 29 Harv. L. Rev. 404, 413 (1916) (though speaking of English law, the quoted provision is applicable to American law).

19. For example, by 1900 corporations, unlike partnerships, could sue and be sued in their own names and were considered citizens and persons under the fourteenth amendment. In 1809 the Supreme Court's position on citizenship was that a corporation was not a citizen for federal jurisdictional purposes because it was merely an association of shareholders and therefore it was the shareholders' state of citizenship and not the corporation's state of incorporation that mattered. Bank of the United States v. Deveaux, 9 U.S. (5 Cranch) 61, 86 (1809). In 1844 the Court reversed itself, stating that a corporation created by a state to perform its functions under the authority of that state and only suitable there, though it may have members out of the state, seems to us to be a person, though an artificial one, inhabiting and belonging to that state, and therefore entitled, for the purpose of suing and being sued, to be deemed a citizen of that state.


In 1853, the Court maintained the same result but changed its theory. It admitted that a corporation could not literally be a "citizen" within the Constitution, but nevertheless, using a forced aggregate reasoning, it established an irrefutable presumption that all shareholders were citizens of the state of incorporation. Marshall v. Baltimore & Ohio R.R., 57 U.S. (16 How.) 314, 328-29 (1853). Speaking in 1903, Henry Atwater stated that it was doubtful that the Court would use the same reasoning as in 1853, but it would undoubtedly reach the same result via another line of reasoning. Atwater, Choice of Corporate Home, 4 Moody's Manual of Corporation Securities 7 (1903). This result fostered the growth of big business (and the consequent separation of management from ownership) by facilitating lawsuits involving
By 1909 the issue of the nature of both partnerships and corporations was not settled; it was in fact highly debated. Theorists also contemplated the nature of a partnership in a debate that mirrored the corporate debate about legal entity, but ultimately, in 1914, an aggregate theory, with certain entity aspects, triumphed. In contrast, in the corporate area the natural entity view was in ascendancy as it best comported with the growth and development of corporations.

Similarly, the 1886 Supreme Court decision in Santa Clara County v. Southern Pac. R.R., 118 U.S. 394 (1886), in which the Court opined that a corporation was a person within the meaning of the equal protection clause of the fourteenth amendment, facilitated protection of shareholders rights through protection of the corporation. Chief Justice Waite stated that the Court would not hear argument on the question of whether a corporation was a person for purposes of the equal protection clause of the fourteenth amendment because the Court was “of the opinion” that it was. Id. at 396. Although the opinion with its use of “person” appears to suggest a natural entity theory, as Morton Horwitz points out, at the time this case was not seen as a promulgation of an entity theory but was really seen as an application of the aggregate theory—that the property of the corporation was really the property of the shareholders and therefore was entitled to protection. Horwitz, supra note 12, at 319-20. This decision, too, despite its use of mixed theory, ultimately facilitated the growth of corporations, the separation of ownership from control and the entity theory: by giving the corporation constitutional rights, shareholders lost standing to sue. Hovenkamp states that although the Progressives claimed that decisions such as Santa Clara were pro-big business, they were really “eminently Jacksonian decisions, representing the constitutional merger of the business corporation into ordinary enterprise.” Hovenkamp, supra note 12, at 1644-45. Thus, another barrier arose between the owners and their corporation.

20. The list of articles during the era is long. On the eve of the Corporate Excise Tax in 1909, the following articles were published on the subject in the Columbia Law Review: Burdick, Partnership Reality, 9 COLUM. L. REV 197 (1909); Hohfeld, Nature of Stockholders’ Individual Liability for Corporation Debts, 9 COLUM. L. REV 285 (1909); Hohfeld, The Individual Liability of Stockholders and the Conflict of Laws (pt. 1), 9 COLUM. L. REV 492 (1909); and Thatcher, Corporate Powers, 9 COLUM. L. REV 243 (1909). In addition, there are the following articles related to regulation of corporations: Canfield, Is a Large Corporation an Illegal Combination or Monopoly Under the Sherman Anti-Trust Act?, 9 COLUM. L. REV 95 (1909); Goodnow, The Constitutionality of the United States Corporation Tax, 9 COLUM. L. REV 649 (1909); and Prentice, Federal Common Law and Interstate Carriers, 9 COLUM. L. REV 375 (1909).

21. If a group of individuals organized an incorporated association that had its own personality and legal existence why should not an unincorporated association be treated similarly? The partnership debate began in 1902 when the Conference of Commissioners on Uniform State Laws requested the Committee on Commercial Law to submit a draft on partnership at the next annual meeting. UNIF. PARTNERSHIP ACT commissioners’ prefatory note, 6 U.L.A. 5 (1969). The major partnership issue at that time was that the then current common law theory was confused as to the rights of a partner and of a separate creditor of a partner vis-à-vis the partnership property. According to William Draper Lewis, who chaired the Committee after the death of the original chair Dean Ames, the Commissioner requested that the law be drafted under the theory that a partnership was a legal person in order to solve these problems. Lewis, The Uniform Partnership Act—A Reply to Mr. Crane’s Criticism (pt. I), 29 HARV. L. REV 158, 162 (1915). Nonetheless, after considerable drafting, discussion and apparent confusion, the Conference in 1914 finally adopted what was generally an aggregate theory although entity aspects were present. According to Lewis the aggregate theory was chosen because the legal person theory (1) abolished too much of the common law, (2) rested on “the fiction of group personality” and an assumption contrary to fact, namely that a third-party considers himself to be dealing with a separate entity (the partnership) rather than
consolidation of corporations. Corporate characteristics of free transferability of interests, continuity of life, limited liability and centralized management also emphasized the distinction between the corporation and its shareholders. Corporate liability was not shareholder liability. The life of the corporation was independent of that of its shareholders. As corporations grew and ownership became separated from management, shareholders became increasingly passive and lost a sense of identification with the corporation. The corporation became a separate entity. This was in contrast to a partner's relationship to a partnership. Partners were generally actively involved in the partnership's business, as well as responsible for the partnership debts. Additionally, the life of the partnership was contingent on the life of its members. These factors created a unity between the partner and the partnership. Legal theory, following these basic differences between a corporation and a partnership, veered toward a natural entity theory in the corporate area, but resisted it, at least partially, in the partnership area.

The natural entity theory, defining corporations as real people, tended to give corporations the same rights as individuals. This tendency is not necessarily logical. Theoretically, corporations could be persons for some purposes but not others, the choice depending on whether an attribute of "personhood" furthered a particular social policy. Alternatively, corporations could be persons, but a different category than individuals, allowing different legal treatment. These approaches, refinements of the natural entity theory, were, perhaps, inappropriate in the stage when the theory was fighting for ascendancy. Such an early stage requires simple, direct and bold brush strokes to clearly delineate the new theory from the old.

Consequently, this new theory had troubling implications for those who wished to regulate the growing wealth and power of corporations. If corporations were natural entities like individuals, with the same rights as individuals, what basis did the government have for imposing regulations only upon the corporations? The artificial entity theory, on the other hand,
because it was grounded in the proposition that the state created the corporation with certain enumerated powers, provided a basis for governmental control. Thus, in discussions of federal regulation of corporations, officials frequently emphasized artificial entity (or even aggregate) views to distinguish between corporations which they wanted to regulate and partnerships and individuals which they did not. Anti-regulation legislators, in contrast, sought to eliminate the distinction between corporations and partnerships by favoring an aggregate view.22

As I shall show shortly, the debate on the Corporate Excise Tax of 1909 similarly contained competing views of corporate theory. Justifications for the tax often rested not on the ascending natural entity theory but on the more ancient and moribund artificial entity theory, as well as on an aggregate theory.

C. Attempts at Corporate Regulation: Federal Incorporation and Publicity

On the eve of the Corporate Excise Tax (and the March, 1909 inauguration of Taft as President), government, business and the public largely agreed that some corporate regulation was necessary. The question was what sort

22. Interestingly, the natural entity view was not raised much. President Theodore Roosevelt, for example; referred to a corporation's artificial nature as a basis for regulating it. In his first annual address to Congress, Roosevelt stated that "[a]rtificial bodies, such as corporations and joint stock or other associations, depending upon any statutory law for their existence or privileges, should be subject to proper governmental supervision". First Annual Message (Dec. 3, 1901), reprinted in 15 Messages and Papers of the Presidents 6641, 6648. In 1902 he stated:

A fundamental base of civilization is the inviolability of property; but this is in no wise inconsistent with the right of society to regulate the exercise of the artificial powers which it confers upon the owners of property, under the name of corporate franchises, in such a way as to prevent the misuse of these powers.


In the 1903 debate in the House of Representatives on H.R. 17 a corporation was called an "aggregation of business enterprises," H.R. 17, 57th Cong., 2d Sess., reprinted in 36 Cong. Rec. 1820 (Feb. 6, 1903) (statement of Rep. Tirrell of Massachusetts), as well as an "artificial creation" of the legislature, given certain special privileges and advantages that natural persons do not, and cannot [sic], enjoy. And by reason of having conferred these special privileges and advantages upon corporations, it becomes the duty of the State and, so far as the United States can, within its sphere, it becomes the duty of the United States, to regulate and control these corporate organizations in order that they may prove beneficial, and not injurious, to the general welfare.

Id. at 1837 (statement of Rep. Littlefield of Maine). The privileges Littlefield mentions are limited liability, unity of control, continuity of life and the ability of the investor to diversify his risk by investing in many businesses. Id. at 1837-38. If the last advantage is interpreted to mean free transferability of interests, then the privileges Littlefield has enumerated are the four characteristics of a corporation, for tax purposes, stated in the Treasury Regulations. Treas. Reg. § 301.7701-2 (as amended in 1983).
of regulation should occur. Although public opinion concerning corporations was complex,23 as early as 1896, it could be divided into two basic approaches.24 The first, largely held by small producers and populists, looked backwards to a golden age of free competition among small businesses. This view held that government regulation was necessary to restore the market of small producers and prevent the harmful and illegal concentration of private market power.25 The second viewpoint, representing the "emergent corporate-capitalist outlook,"26 accepted the existence of large corporations. It held that regulation, preferably by the private market, was necessary to prevent the tendency toward overproduction.27 Federal regulation was needed, if at all, to eliminate the confusion caused by the diversity of state laws.28 By 1909 government regulation at the federal level represented a mix of these two basic approaches. The Supreme Court's interpretation of the Sherman Anti-Trust Act of 1890 favored the small producers' vision of free competition by holding that all combinations were illegal.29 This view was offset by the fact that decisions as to which corporations would be prosecuted were in the executive's hands. The executive branch, first under President Roosevelt and then under Taft, accepted the view that large corporations could legitimately dominate the market.30

23. See, e.g., L. Galambos, supra note 2, at 47-126.
24. M. Sklar, supra note 2, at 54.
25. M. Sklar, supra note 2, at 55.
26. M. Sklar, supra note 2, at 54.
27. M. Sklar, supra note 2, at 55.
28. R. Weibe, Businessmen and Reform, supra note 2, at 212.
29. United States v. Trans-Missouri Freight Ass'n, 166 U.S. 290 (1897). In 1911 the Supreme Court restored the common law "rule of reason" exception to illegal restraints of trade in Standard Oil Co. v. United States, 221 U.S. 1 (1911), and in United States v. American Tobacco Co., 221 U.S. 106 (1911). In Standard Oil the Court modified its past practice, stating that the Sherman Act did not intend to prohibit all restraints of trade; rather "it was intended that the standard of reason which had been applied at the common law and in this country in dealings with subjects of the character embraced by the statute, was intended to be the measure used" to determine whether a particular act violated the statute. Standard Oil, 221 U.S. at 60. With this case the Court introduced the "rule of reason," under which only "unreasonable" restraints of trade were illegal. See, e.g., id. at 67. Under this standard, the Standard Oil Company was held to have violated the Sherman Act.
30. In his first annual message to Congress, President Roosevelt stated that the growth of corporate wealth was due to "natural causes" and not to "the tariff nor to any other governmental action." First Annual Message (Dec. 3, 1901) reprinted in 15 Messages and Papers of the Presidents 6641, 6645. Moreover, he believed that although abuses had occurred, this corporate development had produced enormous good and should be left alone as much as possible. Id. at 6646-47.
Roosevelt consistently reiterated his basic support of corporations, while arguing for some regulation. For example, in his 1907 annual message to Congress, he said:

I am in no sense hostile to corporations. This is an age of combination, and any effort to prevent all combination will be not only useless, but in the end vicious, because of the contempt for law which the failure to enforce law inevitably produces. We should, moreover, recognize in cordial and ample fashion the immense good effected by corporate agencies in a country such as ours, and the
By the early 1900s the real issue, despite the rhetoric against "trusts" and "monopolies" and favoring "free competition," was not how to break up the big corporations, but rather who was to regulate the big corporations, how much they should be regulated and what means should be used to implement regulation. The regulator could be either the federal government, state governments or the corporations themselves. President Roosevelt believed not only that the federal government possessed the power to regulate corporations without infringing upon states' rights, but that the federal government was the only possible regulator since states "absolutely lack the authority to deal with interstate business in any form, and second, because of the inevitable conflict of authority sure to arise in the effort to enforce different kinds of state regulation." President Roosevelt also believed that the executive branch was the appropriate "who" within the federal government.

Wealth of intellect, energy, and fidelity devoted to their service, and therefore normally to the service of the public, by their officers and directors. The corporation has come to stay

Seventh Annual Message, 42 CONG. REC. 67, 68 (Dec. 3, 1907); see also Eighth Annual Message, 43 CONG. REC. 16-17 (Dec. 8, 1908).

31. M. SKLAR, supra note 2, at 180-81.

32. 1908 Annual Message to Congress, 43 CONG. REC. 16, 18 (Dec. 8, 1908).

The opposition to Government control of these great corporations makes its most effective effort in the shape of an appeal to the old doctrine of States' rights.

The proposal to make the National Government supreme over, and therefore to give it complete control over, the railroads and other instruments of interstate commerce is merely a proposal to carry out to the letter one of the prime purposes, if not the prime purpose, for which the Constitution was founded. It does not represent centralization. It represents merely the acknowledgement of the patent fact that centralization has already come in business.

Id. Control of corporations by the federal government would involve "a certain increase in the use of—not the creation of—power by the Central Government." Id.

In earlier speeches Roosevelt was less adamant about the existence of the power of the federal government to control corporations. He believed such power existed, but stated that if Congress felt it was necessary a constitutional amendment should be passed to create the power. First Annual Message (Dec. 3, 1901), reprinted in 15 MESSAGES AND PAPERS OF THE PRESIDENTS 6641, 6649.

33. See, e.g., N. LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904, at 170 (1985). In his 1905 annual message to Congress, President Roosevelt stated that federal control of interstate corporations should be "unequivocally administrative." Fifth Annual Message (Dec. 5, 1905), reprinted in 16 MESSAGES AND PAPERS OF THE PRESIDENTS 6973, 6977

In his 1908 annual message to Congress, Roosevelt stated:

I strongly advocate that instead of an unwise effort to prohibit all combinations, there shall be substituted [for the current Sherman antitrust law] a law which shall expressly permit combinations which are in the interest of the public, but shall at the same time give to some agency of the National Government full power of control and supervision over them. One of the chief features of this control should be securing entire publicity in all matters which the public has a right to know, and furthermore, the power, not by judicial but by executive action, to prevent or put a stop to every form of improper favoritism or other wrongdoing.

Eighth Annual Message, 43 CONG. REC. 16, 17 (Dec. 8, 1908).
Roosevelt, like many others during this era, advocated two tools as primary methods of regulation: federal incorporation and publicity. Taft also advocated these two tools but in a more moderate manner with more emphasis on the judicial branch than the executive branch.

1. Federal Incorporation

Proposals for federal licensing or chartering of corporations occurred as early as the Constitutional Convention; however, during the Progressive

34. The Bureau of Corporations, established in 1903, reflected in its organization and operation the belief in the efficacy of federal incorporation and publicity, as well as Roosevelt's view of the executive as the dominant branch of government involved in supervising corporations. The Bureau, established as part of the newly formed Department of Commerce and Labor, was the first federal agency mandated to regulate industry in general. Act approved Feb. 14, 1903, ch. 552, § 6, 32 Stat. 827-28. The Act stated:

The said Commissioner [of the Bureau] shall have power and authority to make diligent investigation into the organization, conduct, and management of the business of any corporation, joint stock company or corporate combination engaged in commerce among the several States and to gather such information and data as will enable the President of the United States to make recommendations to Congress for legislation for the regulation of such commerce; and to report such data to the President from time to time as he shall require; and the information so obtained or as much thereof as the President may direct shall be made public.

Id. at 828. A detailed description of the Bureau, its operations and its relation to Roosevelt is contained in Johnson, Theodore Roosevelt and the Bureau of Corporations, 45 Miss. Valley Hist. Rev. 571 (1959). See also M. SKLAR, supra note 2, at 184-203.

Because the Bureau reported to the President, rather than Congress, the executive power was greatly enhanced. The President had great discretionary power as to which corporations to prosecute. Under Roosevelt, it was not uncommon for the Bureau and the corporation under investigation to reach a "gentlemen's agreement" under which the corporation would cooperate by providing the Bureau access to information and agreeing to correct violations. In return, the government would not prosecute. This occurred in 1905 with U.S. Steel, for example, and again in 1907 with The International Harvester Company. R. WIESE, BUSINESSMEN AND REFORM, supra note 2, at 46; see also Johnson, supra, at 576, 578 (Roosevelt made the Bureau a "vehicle for executive leadership in dealing with big business"). Some thought the President had too much discretion. Id. at 576. The Bureau also reflected Roosevelt's belief that large corporations were a fact of life and that they were best regulated by federal supervision, by an agency of the executive branch and by some sort of federal licensing.

35. Licensing and chartering are technically different. Chartering would replace state incorporation, whereas licensing would not. Proposals for both were similar and the terms were often used interchangeably, as they will be used here. Urofsky, Proposed Federal Incorporation in the Progressive Era, 26 Am. J. LEGAL Hist. 160, 166 (1982).

36. On August 18, 1787, James Madison proposed that the federal government have the power to charter corporations. For a short but comprehensive history of federal incorporation proposals, see L. LOSS & J. SELIGMAN, SECURITIES REGULATION 152-57 (3d ed. 1989). See also Boyer, Federalism and Corporation Law: Drawing the Line in State Takeover Regulation, 47 Ohio St. L.J. 1037, 1041-42 (1986). In 1934 a Federal Trade Commission Report described the federal history of chartering up until that time. FTC, COMPILATION OF PROPOSAL AND VIEWS FOR AND AGAINST FEDERAL INCORPORATION OR LICENSING OF CORPORATIONS AND COMPILATION OF STATE CONSTITUTIONAL STATUTORY AND CASE LAW CONCERNING CORPORATIONS, WITH PARTICULAR ATTENTION TO PUBLIC UTILITY HOLDING COMPANIES, S. Doc. No. 92, 70th Cong., 1st Sess., pt. 69-A (1934) [hereinafter 69-A FTC UTILITY CORPORATIONS]. The Progressive Era is covered by Urofsky, supra note 35. A good summary of the Progressive Era as well as a good bibliography is provided by Boyer, supra, at 1048-50.
period, particularly 1900 to 1914, interest in such proposals was widespread and intense. Many businessmen supported federal licensing proposals because such proposals provided the advantage of uniform laws instead of a multiplicity of state laws. Opponents saw federal incorporation as an infringement upon states’ rights. Both groups were often surprisingly vague about details of their proposals. In 1902, the Industrial Commission, created by Congress in 1898 to investigate immigration, labor, agriculture, manufacturing, and business, recommended a federal incorporation law. The Bureau of Corporations in its first annual report in 1904 also recommended federal licensing and continued to do so in later years.

In his annual message of 1907, President Roosevelt urged a federal incorporation law for corporations engaged in interstate and foreign commerce, or, if that was “not deemed advisable, a license act for big interstate corporations might be enacted.” The Bureau of Corporations, echoing Roosevelt, described in its annual report for 1908 a voluntary, if possible, system of federal control “based on [the] tested principles of supervision, publicity and cooperation” lodged in an office of the executive branch because administrative supervision could provide the necessary flexibility that judicial procedures could not.

The Hepburn Bill of 1908, amending the Sherman Antitrust Act, would have allowed corporations to voluntarily register with a federal office. The Bureau of Corporation’s 1908 annual report stated that many “prominent” corporate leaders had said they would register their corporations under the

37 Urofsky, supra note 35, at 174-76. The vagueness of the proposals may be a major reason business supported them.
39. 19 INDUSTRIAL COMMISSION, FINAL REPORT 651-52 (1902), as described in L. Loss & J. SELIGMAN, supra note 36, at 153-57
40. REPORT OF COMMISSIONER OF CORPORATIONS FOR FEB. 26, 1903 - JUNE 30, 1904, H.R. Doc. No. 165, 58th Cong., 3d Sess. 44-48 (1904) (reported in L. Loss & J. SELIGMAN, supra note 36, at 154; and Urofsky, supra note 35, at 168-69). In the annual report for fiscal year 1905, for example, the Commissioner stated that “no permanent remedy for existing industrial evils can be expected until Congress exercises more fully its power of affirmative action under the commerce clause of the Constitution.” REPORT OF THE COMMISSIONER OF CORPORATIONS FOR 1905, H.R. Doc. No. 7, 59th Cong., 1st Sess. 75 (1906). The Commissioner sought a federal licensing or chartering law which would allow the government to inspect corporate books and records and stop corporate activities, when necessary. Such a law would allow for “reasonable combinations.” Id. at 75-76.
41. Seventh Annual Message, 42 CONG. REC. 70 (Dec. 3, 1907).
43. Id. at 308.
44. H.R. 19745, 60th Cong., 1st Sess., reprinted in 42 CONG. REC. 3769-70 (1908). In the Senate the bill was introduced April 1, 1908. S. 6440, 60th Cong., 1st Sess., reprinted in 42 CONG. REC. 4212 (1908). The bill also would have modified the Sherman antitrust law to permit reasonable restraints on competition.
Act because they recognized that federal registration was "a commercial asset well purchased by a reasonable degree of publicity." Nonetheless, the bill received a negative report from the Senate Judiciary Committee and was never enacted.

The bill failed for several reasons including the political difficulty, in light of popular aversion to "trusts," of passing any provisions that might be seen as pro-business, as well as an aversion to the activist role the bill would have given the states in regulating the market. Another reason for the Hepburn Bill's failure was the enormous amount of power it gave to the executive branch, as opposed to the legislative and judicial branches of government. Finally, while big businesses might have stated that they favored federal incorporation because it freed them from the confusion of state laws and provided some protection from antitrust prosecution, they undoubtedly recognized the inherent danger in federal registration: the control that would inevitably follow. If the federal government could register, it could also de-register. By creating requirements that must be met to obtain registration, the government could shape the nature of corporations. For example, in the case of the Hepburn Bill, a corporation, once having federally registered, could file its contracts with the federal agency and, if approved, gain exemption for the contracts from prosecution under the Sherman Act. The perilous down-side of this registration, however, was that the government retained supervision of all present and future contracts of the corporation and could at any time revoke registration or decide to prosecute.

The failed Hepburn Bill was Roosevelt's swan song. The debate, however, on the state role in regulation of corporations continued through Taft's and into President Wilson's administration. The debate did not resolve itself entirely until the passage of the Clayton Antitrust Act of 1914 and the establishment of the Federal Trade Commission.

As he stated in his inaugural address to Congress, President Taft saw himself as carrying out his predecessor's policy of recognizing the value of

45. REPORT OF THE COMMISSIONER OF CORPORATIONS FOR 1908, supra note 42, at 310. Many corporations favored the Hepburn Bill because it would have provided immunity from prosecution under the antitrust laws and would therefore have helped the industries stabilize. N. LAMOREAUX, supra note 33, at 171-72.

46. SENATE COMM. ON THE JUDICIARY, AMENDING ANTITRUST ACT: ADVERSE REPORT, S. REP. No. 848, 60th Cong., 2d Sess. (1909) (to accompany S. 6440) [hereinafter SENATE COMM. ON THE JUDICIARY].

47. M. SKLAR, supra note 2, at 282-83. For a discussion of the bill, see id. at 282-85. Another reason for the failure of the bill was its exemption of unions from antitrust prosecution. See, e.g., R. WIEBE, BUSINESSMEN AND REFORM, supra note 2, at 81.

48. M. SKLAR, supra note 2, at 271-82.

49. See SENATE COMM. ON THE JUDICIARY, supra note 46, at 9.

corporations but curbing abuses through federal supervision. Taft’s vision, however, reflected a more conservative faction of the Republican Party and was more respectful of private property than Roosevelt’s program. Taft pulled back from the active executive role envisioned by Roosevelt. Though Taft favored federal supervision and federal incorporation, he saw the judicial branch, not the executive branch, as the primary regulator of corporations.

In Taft’s view, as expressed in his 1910 message to Congress, voluntary federal incorporation, which he advocated, would be administered by a federal agency which would assist Congress in drafting business legislation but would not directly regulate the market. Among other duties, the agency would supervise the issuance of securities; it would also provide for publicity of corporate information. On February 7, 1910, the Taft-Wickersham voluntary incorporation bills were introduced in Congress; nevertheless, Taft vacillated on the issue of federal incorporation.

51. First Annual Message (President Taft), 44 Cong. Rec. 2-3 (Mar. 4, 1909). He reiterated this position in his 1910 message to Congress:

[It] is not, and should not be, the policy of the Government to prevent reasonable concentration of capital which is necessary to the economic development of manufacture, trade, and commerce. This country has shown a power of economical production that has astonished the world, and has enabled us to compete with foreign manufacturers in many markets. It should be the care of the Government to permit such concentration of capital, while keeping open the avenues of individual enterprise and the opportunity for a man or corporation with reasonable capital to engage in business.


52. M. Sklar, supra note 2, at 365-69.


The law should provide for the issue of stock of corporations to an amount equal only to the cash paid in on the stock; and if the stock be issued for property, then at a fair valuation, ascertained under approval and supervision of federal authority, after a full and complete disclosure of all the facts pertaining to the value of such property and the interest therein of the persons to whom it is proposed to issue stock in payment of such property. It should require such corporations to file full and complete reports of their operations with the Department of Commerce and Labor at regular intervals.

Id.

54. S. 1686 was introduced into the Senate by Sen. Clark on February 7, 1910; the identical bill was introduced into the House by Rep. Parker as H.R. 20142 on the same date. See 69-A FTC Utility Corporations, supra note 36, at 38-39. Nevertheless, Taft was seen as wavering on the incorporation issue in February, 1910, because of the American Tobacco and Standard Oil cases then before the Supreme Court. Large corporations favored federal incorporation as a means to avoid the Sherman Antitrust Act. Federal Charter Plan In Abeyance, Financial America, Feb. 1, 1910, reprinted in 69-A FTC Utility Corporations, supra note 36, at 130-31. When the Court decided these cases so as to permit reasonable combinations, corporate support—and Taft’s support—for federal incorporation waned. M. Sklar, supra note 2, at 373-74; see also J. German, Taft’s Attorney General: George W. Wickersham, 236-37 (1969) (unpublished dissertation available from University Microfilm) (vacillation of Taft on the federal incorporation issue; the incorporation law will fend off state socialism).
2. Publicity of Corporations

A less direct, but more widely accepted, method of curing the trust problem than the incorporation solution was to require public disclosure of information concerning corporations. Neither the general public, the government nor the stockholders received much financial information about the large corporations, except in the case of "public" corporations such as railroads and financial institutions. Westinghouse Electric and Manufacturing Co., for example, did not publish an annual financial report or even hold an annual meeting between 1897 and 1905.\footnote{Hawkins, The Development of Modern Financial Reporting Practices among American Manufacturing Corporations, in MANAGING BIG BUSINESS 166, 168 (1986). Other large corporations such as International Silver Co. (producing about 75% of the country's silver products) and the American Tin Plate Co. (controlling 95% of the tin-plate production) also issued no, or almost no information. Id. at 171. A few large corporations such as American Tobacco Co., General Electric Co. and National Biscuit Co. did issue somewhat detailed financial statements in annual reports. Id. at 170-71.} State laws did not require much information either. State laws concerning publicity were of several types: some required only reports to state officials (which were kept confidential), some required reports to stockholders and some provided for publication generally for the benefit of the public. By 1900, only sixteen states required detailed reports to officials; half the states required reports to stockholders (some only upon demand),\footnote{Id. at 173; see also 36 CONG. REC. 1854-57 (Feb. 6, 1903) (Exhibit B to Rep. Littlefield's speech) infra note 98. At common law shareholders had the right to examine corporate records when some property right was involved but not out of mere curiosity or speculative desires. Non-shareholders had no right to inspect corporate books. See also 2 W. COOK, A TREATISE IN THE LAW OF CORPORATIONS HAVING CAPITAL STOCK §§ 511-519 (6th ed. 1908).} and a few required publication of basic information in local newspapers.\footnote{36 CONG. REC. 1854-57 (Feb. 6, 1903) (Exhibit B to Rep. Littlefield's speech) infra note 98.}

Information provided through private channels was also in an early stage of development. Some private credit rating systems had existed in the nineteenth century, but they were rudimentary and limited by technology (no computers, no fax machines and only primitive typewriters) in their information gathering.\footnote{R.G. Dun & Co., for example, provided credit ratings and statements of capital worth as early as 1864. J. Norris, R.G. DUN & Co. 1841-1900, at 84 (1978).} The first decades of the twentieth century saw a rapid growth of private investor services, expanding and consolidating earlier services. In 1900, for example, Moody's issued its first volume of \textit{Moody's Manual of Industrial and Miscellaneous Securities}. The \textit{Manual} contained 1,100 pages describing the larger companies in a fairly standard format, listing a description of property, capitalization, earnings, a rudimentary balance sheet, officers and directors and miscellaneous information such as annual meeting, on which exchange stock was listed and the corporation's
By 1909 the number of corporations listed in the Manual and the information provided had greatly expanded.60 Despite this growth in private

59. 1 Moody's Manual of Industrial and Miscellaneous Securities (1900). Shortly after the Civil War, Poor's began publishing a Railroad Manual; in 1908 it published the first volume of Poor's Handbook of Investors' Holdings "[s]howing ownership of securities by savings banks, trust companies, insurance companies and other institutions, compiled from state and other documents published in the United States and Canada." 1 Poor's Handbook of Investors' Holdings at title page. In 1888 Poor's published Poor's Handbook of Investment Securities which broadened financial analysis beyond railroads to include some industrial concerns. Thus, according to Standard & Poor's, was the "first analytical study of industrial securities published" in the United States. Standard & Poor's 120 Years of Preserving the 'Right to Know' (undated pamphlet on file with the Indiana Law Journal). In 1910 Poor's issued its first Manual of Industrials which contained for each company listed a description of capital stock, some balance sheet information and sometimes a short profit and loss statement. 1 Poor's Manual of Industrials (1910). The detail of the balance sheets and the profit and loss statements varied and was never great in any case.

60. In addition, Moody's added a new section providing analysis of stock values of one hundred railroad securities because, as the publishers stated in their preface, there was "growing demand on the part of the average investor for more technical information regarding the value of securities in which he is interested." 10 Moody's Manual of Railroads and Corporation Securities (1909). The increasing sophistication of the Manual is illustrated by tracing one company through the decade. The 1900 Manual contains information for the American Ship Building Co., incorporated "under New Jersey laws, March 16, 1899, to consolidate [various] ship building and dry dock companies located on the great lakes." 1 Moody's Manual of Industrial and Miscellaneous Securities 584 (1900). After a description of property held and capitalization (note that the company had no bonded debt), there is a brief section on earnings which lists net earnings, dividend paid and balance of earned surplus. Id. at 585. The balance sheet which follows is simple. There are five categories under "assets": plants and property, improvements, material, accounts receivable and cash and "work and construction, balance earned and due us." Id.

By 1903 the separate earnings category had joined the balance sheet in a financial statement. "Assets" had been renamed "resources," but otherwise contained the same categories. The expansion occurred in the Liabilities section which looked as follows:

Capital Stock, Preferred
Capital Stock, Common
Accounts payable
Bills payable (paid in July)
Reserve for maintenance
Reserve for retirement Buffalo mortgage
Earnings
Less dividends paid, 7 percent, on Preferred
Less depreciation and maintenance
Less reserve for maintenance
Less reserve for Buffalo mortgage
Undivided profits for year ending June 30, 1902
Undivided profits, June 30, 1901
Undivided profit or surplus, June 30, 1902


By 1909 five years of statistics were listed for the balance sheet. Assets were divided to include:

Plants and property
Additions and improvements
Materials on hand
Accounts and bills receivable
Due on bonds sold
Cash
Due on construction contracts

10 Moody's Manual of Railroads and Corporation Securities 2269 (1909). Liabilities were
companies providing financial data, the availability of information to the public remained spotty. The New York Stock Exchange, as early as 1869, had a policy requiring listed companies to publish an annual financial report. Not until 1910, however, under threat of government regulation, did the Exchange really begin to enforce its policy. Even with enforcement, companies listed on other exchanges, or over-the-counter, were subject to no such requirement. Finally, what information was published was often of doubtful help due to the disarray in the accounting field where there was little training of accountants and no uniform practices. In sum, public access to corporate information in the Progressive Era may be characterized as sparse, not uniform, but growing.

Government access to information was also limited: certain corporations involved in interstate commerce were required to provide the Interstate Commerce Commission with detailed information as were national banking and savings institutions, but this information was often inaccurate or poorly organized. Moreover, the government had no regular source of information categorized as: preferred stock, common stock, accounts and bills payable, reserve funds and surplus. In addition, there was a section listing five years of statistics on vessels built, capacity, net earnings, dividends paid, depreciation and maintenance, reserve for maintenance and "rebuilding docks, etc." Note that the company still had no bonds, and stock capitalization is the same as it was in 1900: $7,900,000 preferred, and $7,600,000 common stock.

All companies did not have such detailed descriptions. For example, in 1909, American Sewer Pipe Co., with an outstanding stock of $7,000,000 (par value $100), had a much more cursory balance sheet and no information on earnings. In 1909, American Sewer Pipe Co., with an outstanding stock of $7,000,000 (par value $100), had a much more cursory balance sheet and no information on earnings. Id. at 2268.

61. Hawkins, supra note 55, at 180-82. The Exchange's pre-1900 reluctance to enforce its reporting requirement was evidenced by its Unlisted Department. Stocks covered by this Department were actively traded but the companies were not required to furnish financial information. The Department was abolished in 1910 under threats of federal regulation. Id. at 181. The Exchange thereafter actively sought to increase reporting. In 1916, for example, General Motors agreed to publish an income statement and balance sheet semi-annually. Id. In 1926 the Exchange recommended publication of quarterly reports of all listed companies. Id.

The panic of 1907, which many believed was caused by stock manipulation, led to demands for public control of the stock exchange. Various bills were introduced into Congress to that effect, most taxing certain transactions or regulating the use of the mails. None of the bills was enacted. The first university-level department of accounting was established in 1900 at New York University; the American Association of Public Accountants was formed in 1905 (becoming the American Institute of Accountants in 1916). In 1917, the first attempt to establish auditing and reporting standards. Id. at 184-85. Uniform Accounting, published in 1917, was the first attempt to establish auditing and reporting standards. Id. at 186.

63. In his annual report to Congress the Comptroller of the Currency was required to include a summary of the reports he received from the national banks and a statement on the assets and liabilities of state banks and savings associations. This information was to be gathered from the reports filed by these companies with state officials and "[w]here such reports can not be obtained, the deficiency to be supplied from such other authentic sources as may be available." H.R. Doc. No. 195, 61st Cong., 2d Sess. 8-9 (1909). Information filed, however, was not always accurate. See, e.g., Hearings Before the National Monetary Commission on Suggested Changes in the Administrative Features in the National Banking Laws, S. Doc. No. 404, 61st Cong., 2d Sess. 238-39 (1908) (In some cases the report given the
concerning the average corporation engaged in intrastate or interstate commerce. Although the Bureau of Corporations, established in 1903, had investigatory powers, it was without steady access to information about corporations. Both Congress and the President desired access to regular, annual information in order to deal rationally and "scientifically" with a variety of issues, including revenue raising (especially tariffs), antitrust regulation and currency reform.64

Publicity of information about corporations was an important facet of both the Roosevelt and Taft administrations' efforts at federal regulation of corporations, especially regulation of trusts.65 Publicity had at least two meanings. In its broadest sense publicity meant giving the general populace access to information about corporations. In a narrower sense publicity was limited to providing the government with information. Both Presidents Roosevelt and Taft and Congress used the phrase in both senses, not always specifying which sense they meant.66

Congressional attempts at publicity began as early as 1901 when Representative Littlefield of Maine introduced into Congress a bill requiring every corporation engaged in interstate commerce to file with the Secretary of the Treasury a return containing information such as the amount of authorized

Comptroller of the Currency did not agree with the banks' books and records.). The Interstate Commerce Act of 1887 authorized the Commission to require common carriers to submit annual reports using uniform accounting practices prescribed by the Commission "showing the amount of capital stock, funded and floating debt, interest paid, cost of property, number of employed and salaries paid, earnings and receipts, operating and other expenses, balance of profit and loss, annual balance sheet, rates and fares, and miscellaneous statistics." Bureau of Statistics, Interstate Commerce Commission Activities: 1887-1937, at 105 (1937). The original act, however, had no enforcement provision. This defect was not remedied until the Hepburn Amendment of June 29, 1906, which provided, in §20, for penalties for failure to comply. Id. at 107. The Amendment also extended the annual filing requirement to carriers other than railroads and expanded the requirements for monthly and special reports. Id. at 74.

64. See infra notes 284-86 and accompanying text.

65. Roosevelt, in his 1907 annual message to Congress, for example, coupled his call for amendment of the Sherman Antitrust Act with a call for "the compulsory publication of accounts and the subjection of books and papers to the inspection of the Government officials." Seventh Annual Message, 42 Cong. Rec. at 70 (Dec. 3, 1907). In his 1908 Message regarding federal control of corporations he stated that one of the "chief features of this control should be securing entire publicity in all matters which the public has a right to know." Eighth Annual Message, 43 Cong. Rec. at 17 (Dec. 8, 1908). President Taft's support of the 1909 Corporate Excise Tax stressed the publicity aspect. See infra note 197 and accompanying text.

66. Roosevelt, for example, used both senses of the phrase in his 1907 Annual Message to Congress. First, in recommending the amendment of the antitrust laws so as to forbid only harmful combinations, he stated that the government needed to have supervision over businesses engaged in interstate commerce, such supervision including "the compulsory publication of accounts and the subjection of books and papers to the inspection of the Government officials." Seventh Annual Message, 42 Cong. Rec. at 70 (Dec. 3, 1907). Then, in discussing a federal incorporation law, he advocated publicity in its broad sense: "Provision should also be made for complete publicity in all matters affecting the public and complete protection to the investing public and the shareholders in the matter of issuing corporate securities." Id.
stock, par value, amount of stock issued and outstanding, amount paid in
and whether in cash or property, amount of debt, current assets and
liabilities, total earnings, operating expenses, interests, taxes, net earnings
and dividends. Any corporation that had outstanding capital stock which
was not fully paid would, under the proposed legislation, be subject to a
tax equal to one percent of its capital stock. The Secretary would publish
each year "a list of all corporations making returns, showing the condition
of each corporation and its capital stock, for free public distribution . . . ." No action was taken on the bill.

In 1902, the Industrial Commission, in connection with a federal incor-
poration proposal, recommended that corporations publish information of
value to investors and send stockholders annual financial reports. Larger
corporations would be required to publish annual audited reports containing
lists of assets, liabilities, profit or loss. The recommendation was not
adopted by Congress.

In early 1903 a bill bearing the same number, H.R. 17, but substantially
different than the 1901 Littlefield Bill, was introduced. Among other things,
this bill required new corporations engaged in interstate commerce to file
with the Interstate Commerce Commission a return containing, among other
information, the amount of bonds outstanding, the amount of capital stock
issued and outstanding, par value and the amount paid in for stock and
whether in cash or property. Existent corporations were required to file a
return only upon the request of the Commission. The Commission was
required to publish a "list of all corporations making returns, with an
abstract of such returns, for free distribution . . . ." The bill failed because Roosevelt favored the establishment of the Bureau of Corporations
which placed more discretionary power in the hands of the President. In
addition, the Bureau was a less drastic measure than Littlefield's proposal.

67. The bill, H.R. 17, 57th Cong., 2d Sess., is reprinted in 36 CONG. REC. 1786 (Feb. 6,
1903).
68. H.R. 17, § 3, 57th Cong., 2d Sess., reprinted in 36 CONG. REC. 1786 (Feb. 6, 1903).
69. H.R. 17, § 4, 57th Cong., 2d Sess., reprinted in 36 CONG. REC. 1786 (Feb. 6, 1903).
In 1902 the Industrial Commission had recommended the publication of accurate prospectuses
and annual financial reports. 19 INDUSTRIAL COMMISSIONER FINAL REPORT 649-52 (1902) as
described in L. Loss & J. SELIGMAN, supra note 36, at 152-54.
70. 19 INDUSTRIAL COMMISSIONER FINAL REPORT 649-50 (1902), as described in L. Loss & J.
SEILINGMAN, supra note 36, at 150-53.
71. H.R. 17, 57th Cong., 2d Sess., reprinted in 36 CONG. REC. 1786 (Feb. 6, 1903). New
corporations would file a similar report on request of the Commission. Id. H.R. 17 also
contained antitrust provisions, including anti-rebate provisions (§ 5) and denial of interstate
facilities to corporations which violated § 5 or attempted to monopolize or control production,
manufacture or sale (§ 6).
72. H.R. 17, § 3, 57th Cong., 2d Sess., reprinted in 36 CONG. REC. 1786 (Feb. 6, 1903).
73. The bill passed the House, 36 CONG. REC. 1915 (Feb. 7, 1903), but the Senate refused
to consider the bill. 36 CONG. REC. 1931 (Feb. 9, 1903).
74. See H. THORELII, supra note 8, at 538-49; Johnson, supra note 34, at 572-74.
Despite these failures, by 1903 publicity was a key feature of proposed antitrust legislation, accepted at least in principle even by the conservative New York Times. Thus, the first federal measure to regulate all industries, the 1903 law establishing the Bureau of Corporations, gave the President discretionary power to publicize information gathered by the Commissioner of Corporations. In 1905, the Commissioner, commenting on the creation of the Bureau, stated that the Bureau was created due to public opinion on industrial developments which was "vigorous, but confused and vague." Neither the problems nor the solutions were clear, but "upon only one point can it be said that public opinion was fairly clear and unanimous and that point was the desire for 'publicity'—in other words,—the desire for information." Although it was not always clear what information should be gathered, nor for what purpose, the Commissioner agreed that "the demand for accurate information was fundamentally sound."
Despite the Commissioner's somewhat vague statement supporting publicity, publicity was a vital part of attempts to regulate corporations. Provisions for publicity consistently appeared in calls for federal regulation of corporations generally, antitrust regulation, in proposals for federal incorporation and, as I shall show, in the Corporate Excise Tax. Moreover, people could and did articulate several reasons why publicity was so important. First, the power of publicity lay in its exposure of abuse. This was, after all, the era of muckraking. In the words of the Commissioner of the Bureau of Corporations, Bureau actions showed that "[a]gain and again the mere exposure of improper business methods has led to their abandonment without any further action." Second, publicity was a means of gathering information which could serve as a basis for rational government regulation of the corporations. The need for regulation to be both "rational" and "scientific" was a typical concern in the Progressive Era. This concern manifested itself in the area of tariff revision, a hot topic of the times related to the trust issue and from which the corporate tax arose.

Third, publicity could help with the specific problem of watered stock or overcapitalization which was seen by both Presidents Roosevelt and Taft as a major area of corporate abuse, an area which many of the federal incorporation bills addressed. "Stock watering" was intertwined with the mean...
"trust fund" doctrine which held that the paid-in capital of a corporation was a trust for the creditors. Any "watering" was, therefore, a fraud upon the creditors.84

evils, one of the chief being over-capitalization," which needed correction. First Annual Message (Dec. 3, 1901), reprinted in 15 Messages and Papers of the Presidents 6641, 6647.

In 1905 he elaborated on the evils of overcapitalization, the chief abuse of corporations:

[O]vercapitalization often means an inflation that invites business panic; it always conceals the true relations of the profit earned to the capital actually invested, and it creates a burden of interest payments which is a fertile cause of improper reduction in or limitation of wages; it damages the small investor, discourages thrift, and encourages gambling and speculations; while perhaps worst of all is the trickiness and dishonesty which it implies—for harm to morals is worse than any possible harm to material interest, and the debauchery of politics and business by great dishonest corporations is far worse than any actual material evil they do the public.

Fifth Annual Message (Dec. 5, 1905), reprinted in 16 Messages and Papers of the Presidents 6973, 6976.

President Taft also focused on the dangers of overcapitalization generally, and of railroads in particular. On January 7, 1910 Taft sent a special message to Congress to deal with the regulation of interstate commerce. 45 Cong. Rec. 378 (Jan. 7, 1910). Besides his recommendation to establish a commerce court, his other major recommendation was a federal incorporation law which provided for the issue of stock only for cash, or, if for property then at a "fair valuation, ascertained under approval and supervision of a federal authority, after a full and complete disclosure of all the facts pertaining to the value of such property and the interest therein of the persons to whom it is proposed to issue stock in payment of such property." Id. at 383. Corporations also could not hold stock of other corporations without approval by the federal authority.

The Taft-Wickersham bills, introduced into the 61st Congress on February 7, 1910, provided for a minimum capital stock of $100,000, the filing with a federal agency if stock was issued for property and the necessity of approval by the Commissioner of Corporations to increase capital stock. S. 6186 and H.R. 20142 as described in 69-A FTC Utility Corporations, supra note 36, at 8-9, 38-39.

In February, 1910, Sen. Newlands introduced a federal incorporation bill, similar to ones he had introduced for the preceding five years, which regulated issuance of stock. 69-A FTC Utility Corporations, supra note 36, at 13. Similarly, Sen. Dolliver, on May 26, 1910, introduced an amendment to the Interstate Commerce Act governing the issuance of stock and limiting the issuance of debt. Id. at 14-15. Section 14 of his amendment stated that the date of maturity of debt could not exceed 50 years, the interest rate could not exceed six percent and the amount of debt could not exceed the amount of capital. Id. at 14.

84. The "trust fund" or "American" doctrine was first articulated by the Supreme Court in Sawyer v. Hoag, 84 U.S. (17 Wall.) 610 (1873): "Though it be a doctrine of modern date, we think it now well established that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund for the benefit of the general creditors of the corporation." Id. at 620. This theory was later rejected in such cases as Hospes v. Northwestern Mfg. & Car Co., 48 Minn. 174, 50 N.W. 1117 (1892), which held that corporate property could not be seen as held in trust since the corporation had legal as well as beneficial right to any property. A corporation is "a trustee for its creditors in the same sense and to the same extent as a natural person, but no further." Id. at 193, 50 N.W. at 1119. To recover, the court said the creditors must show that they were defrauded by the stockholders. The problem of watered stock and shareholder liability for it "represented one of the two or three most important issues in corporate law during the late nineteenth century and generated hundreds of cases and thousands of pages of legal writing." Horwitz, supra note 12, at 349. By 1909, the time of the Corporate Excise Tax, some courts rejected the theory, but the issue was by no means settled. It continued to cause problems and discussions during the Progressive Era. See
Stock watering or overcapitalization also struck at the heart of the trust issue. This occurred in two ways. First, there was a belief that the large combination of trusts could not have occurred without stock watering. For example, in the 1903 debates on H.R. 17, Representative Littlefield of Maine stated:

> It is doubtful if any of the large overcapitalized combinations now in existence could have been financed if the facts as to value involved in their organization had been fully known to the public. In a great many instances the bonds negotiated represent all of the actual investment in the corporation, the stock being largely speculative. It is certainly doubtful if the public would buy a bond when it knew that the only cash capital invested in the enterprise was the proceeds of the bonds in which it was invited to invest.\(^5\) 

Thus, overcapitalization or stock-watering led to the very creation of trusts. It was harmful to the investing public who bought bonds they otherwise would not buy: “Where is the individual who, proposing to engage in any enterprise, would have the courage to go into the market and endeavor to borrow, secured by a mortgage on the enterprise, all the capital to be invested therein?”\(^6\) Prospective buyers were at risk because, unlike the purchasers of a horse, a farm or other tangible property, they could not evaluate the worth of the bond or stock by examining it, or even by reading a prospectus.\(^7\) Publicity, however, would give the prospective investor the information necessary to make a reasoned decision as to whether to purchase the stock or bond.\(^8\) Both Roosevelt and Taft suggested publicity in matters connected with issuance of securities in order to protect investors.\(^9\)

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\(^5\) Wickersham, *The Capital of a Corporation*, 22 Harv. L. Rev. 319 (1909). Morton Horwitz notes that the decline of the “trust fund” doctrine, which began in the 1890s, was paralleled by the growth of large corporations, the division between stock ownership and control and the rise of the “natural entity” theory of corporations. Horwitz, *supra* note 12, at 349-56. The theory made sense when the corporation was conceived as a mere aggregate of the individual shareholders (a partnership model) but made little sense under a “natural entity” model of corporations under which the corporate entity and the shareholders were separate entities. Horwitz, *supra* note 12, at 355-56. See *supra* notes 14-19 and accompanying text for the entity and aggregate models.


\(^7\) 36 Cong. Rec. 1842 (Feb. 6, 1903) (statement of Rep. Littlefield) (Obviously, this is before leveraged buy-outs!).

\(^8\) Id.

\(^9\) Id.

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85. Id.

86. Id.

87. Id.

88. Id.

89. In a 1910 message to Congress, Taft, citing the 1908 Republican platform which favored such supervision as will prevent the future overissue of stocks and bonds by interstate carriers . . . recommend[ed] the enactment of a law providing that no railroad corporation subject to the interstate-commerce act shall hereafter for any purpose connected with or relating to any part of its business governed by said act, issue any capital stock without previous or simultaneous payment to it of not less than
Overcapitalization, the argument continued, did not just endanger the investor, it harmed the general public, the consumer. The real purpose of overcapitalization was to increase artificially the worth of the stock and thereby increase prices above their "natural normal level." Prices, the argument went, must be at a level so that the enterprise would earn enough profit so that there was a "fair return" on the capital, but not more.

An actual investment of $1,000,000 would require a price for the product that after the payment of operating expenses and fixed charges would yield in profit, say, $60,000. On the other hand, if $10,000,000 actual investment were employed in the same enterprise, with the same output, the net earnings would have to be $600,000 in order to give the same fair return on the investment.

Assuming, for the purpose of testing this idea, that all the other elements, such as cost and output remain the same, clearly in the last instance the public must pay a largely increased price by reason of the large investment. If, for the purpose of the illustration, $9,000,000 of this were overcapitalization or inflation, the public would be clearly paying in price $540,000 more than it ought to pay.

Overcapitalization, by concealing true profits, stifled competition. What looked like a six percent dividend on a $1,000,000 investment could really, due to overcapitalization, be a twelve percent dividend on only a $500,000 investment. Because of this stock-watering other enterprises would not enter the business since they did not realize how profitable the business was.
Publicity would help cure this by providing accurate information about capitalization in order to determine a fair price.\textsuperscript{92} George Wickersham, Taft's attorney general, published an article in the \textit{Harvard Law Review} on the eve of Taft's inauguration dealing with overcapitalization.\textsuperscript{93} Unlike others, he did not get carried away by trust-busting rhetoric. The issue, he said, was not overcapitalization per se, but lack of information: "The real evil is not so much in over-capitalization, or in exaggerated valuation of property constituting a part of the capital stock as it is in the misrepresentation or concealment of material facts in soliciting financial aid for the corporation."\textsuperscript{94} "Strained construction and forced analogies" of the trust fund doctrine would not be needed if "laws were modified so as to require full, frank disclosure of all the facts concerning the property serving as a basis for stock issue, and safeguards as to its valuation . . . ."\textsuperscript{95} Publicity would solve the problems created by the trust fund doctrine as well as solve the underlying problem which the trust fund doctrine was invented to cure.

Publicity, in short, was implicated at the most basic level of the economy: fair prices, fair returns on investment and the very existence of competition. Even those people (such as Roosevelt and Taft) who accepted the existence of large corporations and advocated their advantages (efficiencies of scale, for example)\textsuperscript{96} had to deal with these issues.

Once the existence of large consolidations was acknowledged, free competition could not be relied on for market regulation. Publicity was part of the alternative to free competition. Publicity would help control prices and encourage, at least potentially, competitors. This critical rationale for publicity accounts for the "emphatic, indeed impassioned, advocacy of publicity of corporate affairs by Roosevelt, Taft, and Wilson, alike to guard against stock-watering and secretive accounting, which might conceal improper prices and excessive returns."\textsuperscript{97}

In sum, publicity was necessary for a variety of reasons. Publicity was an end in itself in that exposure of abuses often was enough to correct

\textsuperscript{92} 36 \textsc{Cong. Rec.} 1843 (Feb. 6, 1903) (statement of Rep. Littlefield).
\textsuperscript{93} Wickersham, supra note 84.
\textsuperscript{94} Wickersham, supra note 84, at 338.
\textsuperscript{95} Wickersham, supra note 84, at 338.
\textsuperscript{96} 36 \textsc{Cong. Rec.} 1842 (Feb. 6, 1903) (statement of Rep. Littlefield).
\textsuperscript{97} M. \textsc{Sklar}, supra note 2, at 379-80; \textit{see also} H. \textsc{Thorrelli}, supra note 8, at 321. Publicity was essential to the concept of oligopolistic price, defined as that price which yielded a fair return on real investment and assets, and which spurred or did not obstruct innovation and rising efficiency; that price and rate of return above which competition, either direct or indirect by substitution would be induced. In keeping the field open to the threat of new investment, if not new investment itself, publicity was the corollary of regulation against unfair practices. Together, publicity and policing business practices constituted the regulatory equivalent of competition.

M. \textsc{Sklar}, supra note 2, at 380.
them. Second, publicity enabled the government to gather information preparatory to further legislation. Third, publicity could help protect investors. Finally, publicity was a substitute for market regulation; it was a means of obtaining fair prices and allowing at least potential competition.

To be effective, publicity needed to occur at the federal level. To begin with, many states provided for little or no publicity of information. However, even if all states were to provide adequate information, it was unlikely that they would provide for uniform information. Yet to be useful information needed to be uniform. Furthermore, if the information were required at the federal level, access to it would be easier than if information were spread out all over the country at the state level.

In 1909 a special committee of the New York state bar investigated the matter of overcapitalization and concluded that the popular belief that overcapitalization deceives the public "may have been greatly exaggerated." Nevertheless, the committee concluded that, despite its falsity, the belief hurt business and the perceived problem needed to be cured. Interestingly, the committee's solution was no-par stock. The committee's thinking was slightly ahead of that of the populace and the government since both Roosevelt and Taft proposed to deal with the problem through measures governing stock issuance and publicity. The Corporate Excise

98. Representative Littlefield, in his 1903 speech on H.R. 17, provided in his Exhibit B a summary of state laws on the subject. 36 Cong. Rec. 1854-57 (Feb. 6, 1903). While this list must not be taken as definitive, it does show the variety of laws on the subject and the limited amount of information stockholders, let alone the public, often had access to. In New Jersey, for example, stock books were open to shareholders thirty days before an annual meeting. In Texas, upon request by one-third of the shareholders, the directors had to make a report on "the situation and amount of business." Several jurisdictions (e.g., Tennessee, North Dakota, District of Columbia) provided for annual publication in a local newspaper of information about capital stock and liabilities, and sometimes of a list of shareholders. Other jurisdictions (e.g., Nevada, Idaho, New Hampshire) provided creditors with access to books as needed. At common law shareholders had access to books and records. 14 Corpus Juris Corporations §§ 1298-1301 (1919). See id. §§ 1302-1303 for statutory and constitutional provisions.

101. Id.
102. For example, in 1908 President Roosevelt had asked Congress to deal with three issues, including the "question of overcapitalization, either through Federal license or by some provision securing Government supervision of the issues of stock and bonds by inter-State corporations." Trust Law Changes Don't Satisfy Labor, N.Y. Times, Mar. 24, 1908, at 2, col. 6. The article concerns the introduction of the Hepburn Bill to amend the Sherman Act. The two other measures Roosevelt wanted Congress to deal with were employer liability and amendment of the Sherman Act to permit reasonable combinations. Id. Many states also attempted to deal with the issue of stock-watering or overcapitalization. What the Governors Say About Corporations, 1 Corp. Tr. Co. J. (Supp. Feb. 1909) (pages unnumbered); see also supra note 92 and accompanying text. The first state to enact legislation permitting no-par stock was New York in 1912. See Coffee, The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role, 89 Colum. L. Rev. 1618, 1636-37 (1989).
Tax, as I shall show, dealt with the overcapitalization issue directly through a publicity feature and less directly through its interest deduction provision.

Frequently, publicity proposals distinguished among corporations, calling for more publicity for large corporations than for small. In 1908 the National Incorporation Committee of the powerful National Association of Manufacturers reported that it favored national incorporation and publicity, however:

A clear distinction should be made in the laws regarding publicity between corporations which list their stocks for sale on stock exchanges and those private corporations which do not.

Those who appeal to the public to deal in their stocks should explain to the public; those who do not should be required only to report to their stockholders.

Generally speaking, publicity is inconsistent with the successful conduct of competitive business.

This statement foreshadows the 1909 Corporate Excise Tax debate both in its concern for privacy to protect business secrets and its distinction between types of corporations which should be subject to publicity. Excepting private corporations from widespread publicity obviously served the interests of small businesses. But it did so without defeating the major purpose of publicity to the general public. That purpose was to give investors information so they could choose investments wisely and avoid promoter schemes. Investors needed this information only as to possible investments. Only corporations which offered their stock to the public were possible investments; thus, only these corporations needed to comply with broad publicity laws.

Businessmen as well as presidents and other government officials supported publicity. Many called it a "great safeguard," but conveniently omitted any details. Possibly, they supported it for the theoretical reasons of ensuring fair prices. More realistically, they supported it because of its very vagueness. By supporting publicity, they could favor regulation which would not impose any significant restrictions upon them but at the same time would fend off more serious regulatory attempts.

D. Summary

By the time of Taft's inauguration in March, 1909, the corporate restructuring of America was well underway with the major consolidation of the...
great corporations just accomplished. Congress had been debating the trust issue for almost two decades but had actually passed little legislation. The two major legislative accomplishments were the passage of the Sherman Antitrust Act in 1890 and the establishment of the Bureau of Corporations in 1903. The Supreme Court interpreted the Sherman Act as abolishing common law "reasonable restraints" on trade while the Bureau of Corporations argued for the acceptance of reasonable restraints and the regulation of large corporations. President Roosevelt had selectively enforced the Act, using his executive discretion under the Bureau to reach gentlemen's agreements rather than instituting prosecutions. Roosevelt, by the end of his term, had sketched out a vision of active federal regulation of corporations with the executive branch, rather than the judicial or legislative branches, taking the predominant role. Two of his tools for regulation were federal incorporation or registration and publicity, both of which were present in the Hepburn Bill of 1908, the most recently failed attempt at federal regulation. President Taft took a more conservative view of government action in the area, favoring less government regulation and more deference to the judicial branch. Taft did, however, support federal incorporation and publicity. Publicity, in fact, was a key reason for his support of the Corporate Excise Tax. Underpinning attempts at regulation through publicity and federal incorporation was the view that corporations were artificial entities, as opposed to the conception of corporations under the competing aggregate and natural entity theories.

II. A BRIEF HISTORY OF FEDERAL INCOME TAXATION OF CORPORATIONS BEFORE 1909

On the eve of Taft's inauguration, the government had traditionally raised most of its revenues through various excise taxes, including some on corporations. During the Civil War, under the press for revenue, the federal government passed its first income taxes. These income taxes, beginning in 1861 and ending in 1871, were relatively small sections of much larger

107 The first income tax was enacted in August, 1861, and was never collected because Congress expected to amend it shortly. S. RATNER, AMERICAN TAXATION 68 (1942). The Act was passed instead of a bill taxing real estate only, as the latter was objected to on a constitutional basis as a direct tax. E. SELIGMAN, THE INCOME TAX 431-32 (1911), referring to congressional debate in the CONG. GLOBE, 37th Cong., 1st Sess. 246-49, 252, 268, 272, 282, 325 (1861). The Act imposed a three percent tax on the income above $800 of every person. Act approved Aug. 5, 1861, ch. 45, § 49, 12 Stat. 292, 309. The tax appeared to be on gross income since no deductions were provided for. The intent, however, was to tax only net income, delegating to the Secretary of the Treasury the authority to allow deductions from gross income. S. RATNER, supra, at 67; E. SELIGMAN, supra, at 434 (citing CONG. GLOBE, 37th Cong., 1st Sess. 321 (1861)). In July, 1862, Congress did in fact repeal the 1861 income tax provisions and imposed instead a new tax on income in excess of $600 on "every person
revenue bills imposing a variety of taxes including imposts or duties on certain products, and excise taxes, measured by gross receipts, on individuals, companies and corporations engaged in certain businesses. The income taxes were taxes on the income of individuals, including dividends and interest received from corporations. However, certain corporations, mostly those of a public nature such as those engaged in banking or transportation, were required to pay taxes on dividends and interest payments and individuals could accordingly deduct these payments from income or, in later acts, receive a deduction for the tax paid by the corporation.

Because of the deduction given individuals for taxes paid by the corporation, the tax paid by corporations on dividends and income appeared to be merely a withholding at the source and not a separate tax on corporations. Nevertheless, the Supreme Court was confused as to whether the statutes imposed a tax on corporations. The Court first held that this tax was not part of the income tax, but was a separate tax imposed on the corporation, not the shareholders and bondholders; later in the same year, in apparent contradiction of its earlier opinion, the Court stated that the tax was not a tax on the corporation but was a tax on the shareholder or bondholder residing in the United States. The tax was slightly graduated: three percent on $601-$10,000; five percent on over $600 if total income exceeded $10,000. The Act also created a Commissioner of Taxes in the Bureau of Internal Revenue. Income tax acts were also passed in 1863, 1864, 1865, 1866, 1867 and 1870. The 1870 Revenue Act provided for the expiration of the income tax at the close of 1871. Act approved July 14, 1870, ch. 255, § 6, 16 Stat. 256, 257.

Because a gross receipts tax singled out occupations, not corporations, it was really an occupation tax similar to earlier state taxes. For example, in 1777 Maryland imposed a tax of 0.25% on the profit of "every person practising law or physics, every hired clerk acting without commission, every factor, agent or manager trading or using commerce in this state." E. Seligman, supra note 107, at 379 (quoting Maryland Laws of 1777, ch. 22, §§ 5, 6).

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(and thus part of the income tax). Not surprisingly, the lawyers in the first case asked for a rehearing on the ground that the cases were inconsistent. The Court denied a rehearing for the case. Clearly, there was confusion as to what (or whom) was being taxed.

While the Supreme Court appeared confused as to whether the dividend and interest tax was a separate tax on corporations or merely a withholding device, another section of the income tax lent credence to the withholding interpretation. The 1864 Act included in an individual's income "the gains and profits of all companies, whether incorporated or partnership . in estimating the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise."

The Act ignored the corporation as an entity (real or artificial) and, treating it as a mere aggregate of individuals, taxed the income earned by the corporation to its shareholders. In modern parlance, the Act integrated corporate and individual taxes by taxing the individual on all business income, no matter what entity earned it and no matter whether it was distributed. If the money was distributed as interest or dividend the corporation withheld the tax and the individual was allowed to deduct the interest and dividend income from her income. Undistributed profits were taxed to the individual also, but no provision was made in the Act to provide for a deduction or exclusion for this income when it was actually distributed.

113. United States v. Railroad Co., 84 U.S. 322 (1872). In 1911, Edwin Seligman, the noted tax expert, viewed the 1864 tax on dividends and interest withheld by the corporation as really a part of the income tax. E. SELIGMAN, supra note 107, at 444. He contrasted this stoppage at the source with the gross receipts tax which was "supposed to hit the ability of the corporation itself." Id. at 472.

114. Barnes, 84 U.S. at 335; see also Railroad Co. v. Collector, 100 U.S. 595, 598 (1879) (section 122 of the 1866 Act is an excise tax on the business of a corporation). In Railroad Co., the Court said that Congress intended the Act to "levy the tax on the net earnings of [the specified] companies." Id. Congress could chose to tax the earnings after deducting interest paid on debt or it could include that interest as part of net earnings. It choose to include interest in earnings. Id.

115: Act of June 30, 1864, ch. 173, § 117, 13 Stat. 223, 282. The companies mentioned in the section are those that withheld taxes on interest and dividends as in the 1862 Act. The companies specified were those which withheld taxes on interest and dividends. Although the 1862 Act only included in an individual's income dividends paid by a corporation, the Commissioner attempted to also include in an individual's income her share of the corporation's undistributed profits. In Magee v. Denton, 16 F Cas. 382 (C.C.N.D.N.Y. 1863) (No. 8,943), the collector of internal revenue had assessed the plaintiff Magee on his share of corporate profits which had not been distributed but spent on corporate repairs and improvements. Magee sued to enjoin the collection of the tax on the basis that "the profits of an incorporated company, itself an artificial person, are not, in the contemplation of the act of congress, a portion of the gains, profits, or income of the stockholders, until they are distributed as dividends, or embraced in a dividend declared by the managers of the corporation ." Id. at 383. The court denied the injunction, without deciding whether undistributed profits were income, on the grounds that declared but unpaid dividends were clearly income to the stockholder, and that the plaintiff had not stated that no dividends had been declared. Id.
The Supreme Court considered the issue in Collector v. Hubbard\(^\text{116}\) in which it reversed a Connecticut superior court's holding that undistributed profits were not income to shareholders because under well-settled state law shareholders were not entitled to profits until the directors declared a dividend.\(^\text{117}\) Although the Court reversed the ruling on procedural grounds,\(^\text{118}\) it stated that even if the statute did not bar the suit, the taxpayer was still liable for the tax. While acknowledging that for other purposes a shareholder is not entitled to profits until the directors declare a dividend, the Court stated that for tax purposes, the shareholder is entitled to undistributed profits because those profits immediately become incidences of the shareholder's ownership of the stock: the value of his property has immediately increased and he can sell, gift or devise the stock (and its enhanced value) or he can retain it and receive future dividends from the current profit.\(^\text{119}\) The Court concluded by saying that the "decisive answer" was that Congress had the power to tax and that taxing undivided profits fell within that power.\(^\text{120}\)

The Court's analysis is interesting. It acknowledged the separate existence of the corporation for state law purposes, but nevertheless found that the shareholder had income. In order to do this the Court did not ignore the corporate entity entirely, but did ignore it for tax purposes. This partial disregard of the entity appears to rely on an economic theory of income that holds that a person has income when her net wealth has increased,

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\(^{116}\) 79 U.S. (12 Wall.) 1 (1870).

\(^{117}\) The Connecticut Supreme Court in Hubbard v. Branard, 35 Conn. 563 (1869) followed the earlier case of Ex parte Ives, 13 F Cas. 179 (D.C. Conn. 1865) (No. 7,114), which had also noted that dividends were not a matter of right for the shareholder since in many cases directors could not declare dividends but had to use profits to pay debts. Id. at 180-81. Ex parte Ives is the only other case on point. Given the apparent enormity of the undistributed profits provision, it is peculiar that neither courts nor commentators paid it much attention. Even Edwin Seligman ignored the provision in his detailed discussion of the 1864 Act. E. SELIGMAN, supra note 107, at 430-80.

\(^{118}\) The Court held that an 1866 amendment to the 1864 Act prohibiting suits in any court unless appeal had first been made to the Commissioner of Internal Revenue applied to state courts as well. Hubbard, 79 U.S. at 14-15 (referring to Act approved July 13, 1866, ch. 184, § 19, 14 Stat. 98, 152).

\(^{119}\) Hubbard, 79 U.S. (12 Wall.) at 17-18.

\(^{120}\) Id.
regardless of whether realization, that bugaboo of tax, has occurred. More likely, however, the Court was merely following an artificial entity theory in that it recognized the corporation as an entity only for those certain purposes granted by the state.

The first federal income tax statute to clearly tax corporations was the 1894 Act. Section 27 imposed a two percent tax on the income of individuals and section 32 imposed a similar tax on corporations. Integration occurred

121. A classic economic definition of income is found in H. SIMONS, PERSONAL INCOME TAX (1938): "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question." Id. at 50.


Eisner v. Macomber, 252 U.S. 189 (1920), held that income does not occur until realization occurs, that is, the income is separated from the capital. The government had relied on Hubbard but the Court replied that Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895), overruled Hubbard. The government replied that the sixteenth amendment overrode Pollock, but the Court disagreed since the amendment applied only to income and to be income the gain must be separated from the capital.


123. Id. § 32, at 556. The tax bases for both individuals and corporations were similar. In particular, both could deduct interest paid or accrued. Individuals included in income interest received or accrued less interest due or paid by the individual and deducted all expenses necessary in carrying on any business or profession including "all interest due or paid within the year by such person on existing indebtedness." Id. § 28, at 553. Corporations were taxed on net profits "above actual operating and business expenses, including interest on bonded and other indebtedness." Id. § 32, at 556. Interest deductions were not mentioned in either the 1861 or 1862 Acts. However, congressional debate did occur on the matter in 1862. One commentator has stated that this debate shows that Congress "evidently believed that the income base implied, inter alia, a deductible interest expense." Berger, Simple Interest and Complex Taxes, 81 Colum. L. Rev. 217, 219 (1981) (citing Cong. Globe, 37th Cong., 2d Sess. 1513-32 (1862)). The debate actually shows some confusion and even indicates that many Congressmen felt that no interest was deductible. First, Morrill of Vermont moved to deny a deduction for personal and family expenses; this passed, with no vote being given. Cong. Globe, 37th Cong., 2d Sess. 1532 (Apr. 3, 1862). Morrill then proposed that interest on land not be deductible, explaining: "A great many persons may owe debts, some on their farms and some on other things. We do not deduct any debts." Id. Congressman Mallory responded that interest on real estate that produced income should be deductible. Id. Mr. Hickman then stated:

It is not contemplated, as I understand, that the indebtedness of a man shall enter at all, as a general thing, into or modify his taxation. There is no more reason, I apprehend, why the farmer shall be relieved from taxation on the amount of his indebtedness for land than why I should be relieved from my taxation on account of indebtedness for my personal effects.

Id. White of Indiana then requested that the restriction on interest be extended to "other productive capital out of which such income proceeds." Id. This was rejected by a vote of 50 to 46, but Morrill's original amendment excluding interest on the value of land was adopted.


Under the 1870 Act, non-business interest expenses could only be offset against interest income whereas business interest expenses could be deducted without limitation. Berger, supra,
through the exclusion from an individual's income of dividends received from corporations which already had paid the two percent tax.\footnote{124} Because the 1894 Act and the debate concerning it dealt with many of the issues raised in 1909, a closer look is valuable. Congress grappled with the issue of corporate personality and whether corporations could or should be taxed separately from individuals. The result was mixed. On the one hand, Congressman William Wilson, chair of the House Ways and Means Committee, rested his support of the corporate tax on a corporation's separate identity and the special privileges it enjoyed, especially limited liability.\footnote{125} Wilson's stress on the artificial nature of the corporation and its special privileges was reflected in the House version of the bill which taxed only for profit corporations and associations "organized under the laws" of the United States, a state or territory, "by means of which the liability of the individual stockholders is in anywise limited."\footnote{126} Without discussion the Senate changed this language, taxing only "corporations, companies, or associations doing business for profit in the United States, no matter how created and organized, but not including partnerships."\footnote{127} The Senate language, ultimately adopted,\footnote{128} seems to rely on a natural entity theory in contrast with the House's version which fits an artificial entity theory. The Corporate Excise Tax, as will be seen later, resurrected the House language.

Both versions apparently established the corporation as an entity separately taxable from the individual. This separate taxability was denied to some extent by integration of the taxes achieved through the exclusion from income of dividends tax.\footnote{129} Integration was only partial, however, 

\footnote{at 219 (citing 11 I.R.R. 89, 97).}
\footnote{The bill as it came to the Senate from the House of Representatives did not allow corporations to deduct interest in computing net profits. The Senate added this provision. 26 CONG. REC. 6831 (June 26, 1894).}
\footnote{124. Act of Aug. 27, 1894, ch. 349, § 28, 28 Stat. 509, 554.}
\footnote{125. Corporations, he stated, were "a class of citizens" who owned and controlled large amounts of wealth and enjoyed certain public franchises ...and who therefore [had] no right to object to some public scrutiny of their incomes in view of the exemption from personal liability of stockholders, and other privileges which corporations enjoy, but which the individual business or professional man cannot enjoy, the equity of a tax upon their net earnings seems the more apparent, while the ascertainment of those earnings would generally be easy and reasonably accurate, and free from the offensive inquisition so much declaimed against in the case of the individual. Wilson, The Income Tax on Corporations, 158 N. AM. REV 1, 7 (1894). He also thought the supervision "might be salutary in its influence." Id.}
\footnote{126. 26 CONG. REC. 6831 (June 26, 1894).}
\footnote{127. Id. at 6833.}
\footnote{128. Act of Aug. 27, 1894, ch. 349, § 31, 28 Stat. 509, 556.}
\footnote{129. Id. § 28, at 554.}
because corporations, unlike individuals, had no exemption amount.\textsuperscript{130}

The lengthy exemption debate is worth a detailed look for the information it yields about attitudes toward corporations generally, the legal nature of corporations, federal-state relations and taxation. Those Senators favoring an exemption for corporations similar to that for individuals acknowledged that corporations "were entities in a sense" but viewed the corporation as primarily an aggregate of individuals who would be harmed by the failure to grant corporations a $4,000 exemption.\textsuperscript{131} The harm was most clearly delineated in the example given by Senator Hoar from Massachusetts in which he stated that small corporations had replaced partnerships as the mode of operating businesses and then described "five little grocers . . . or five mechanics. Each of them gives his individual work, hard day's work, and the profit of the concern is $5,000. That is a thousand dollars apiece."\textsuperscript{132} Hoar felt that the bill was unfair because it did not allow each little grocer or mechanic to get his $1,000 out of the corporation because the corporation had to pay a corporate tax. Ignoring the ability of the corporation to pay that money out as deductible salary and not as a dividend, Hoar argued that the tax on the corporation was really a tax on the individual. Consequently, he proposed an amendment giving a corporation an "exemption equal to the aggregate of the exemptions to which such stockholders would be entitled in estimating their individual tax, not including, however, any exemption which may have been allowed to such stockholders as individuals."\textsuperscript{133} Several other amendments to the bill, not all as artfully drawn, were proposed to achieve the same purpose, but all, like Hoar's, were defeated.\textsuperscript{134} Some proposed amendments attempted to exempt only small corporations, those that were basically incorporated partnerships.\textsuperscript{135}

Most proponents of the corporate exemption did not object to taxing the corporation on undivided surplus.\textsuperscript{136} Although such a tax would be on the corporate entity, in a sense it was just premature withholding from the individual.\textsuperscript{137} In effect, proponents argued for integration of taxes,

\textsuperscript{130} Individuals paid tax only on income in excess of $4,000. \textit{Id.} § 27, at 553. However, they were required to file returns if income exceeded $3,500. \textit{Id.} § 28, at 554.

\textsuperscript{131} \textit{E.g.,} 26 \textit{Cong. Rec.} 6868 (June 27, 1894); \textit{see also id.} at 6874 (statement of Sen. Higgins) (corporations are "but aggregations of the capital of individuals for joint profit"); 26 \textit{Cong. Rec.} 6876 (statement of Sen. Aldrich) ("A corporation is simply an aggregation of individuals.").

\textsuperscript{132} \textit{Id.} at 6877.

\textsuperscript{133} \textit{Id.}

\textsuperscript{134} \textit{See id.} at 6855-88. A similar discussion occurred the previous day. 26 \textit{Cong. Rec.} 6832-35 (June 26, 1894).

\textsuperscript{135} 26 \textit{Cong. Rec.} 6879 (June 27, 1894) (statement of Sen. Allison) (exempt corporations having capital, including capital surplus of $80,000 or less).

\textsuperscript{136} \textit{Id.} at 6881-82.

\textsuperscript{137} Presumably, there would be some mechanism for crediting the tax when the surplus was dividended out, but no mention is made of this.
recognizing the corporate entity as a mechanism for collecting tax but not recognizing it as a separate taxable entity. Foreshadowing current economic thought, one Senator stated that "an income tax is either a tax upon the personal earnings of an individual or else it is double taxation." Thus, not giving a corporation an exemption discriminated against corporate investment; the corporate exemption was needed not for the sake of corporations but "because it is right and just to individuals."

Opponents of the exemption, however, saw the corporation as a separate legal entity subject to taxation like an individual. Senator Vest was the most eloquent defender of this position. Using a benefits theory of taxation, he stated that although corporations were incorporated by states, they received federal benefits, in the way of protection, just like any individual and therefore should pay tax just like any individual. Individuals received an exemption because they paid import duties and other taxes; since corporations did not, they were not entitled to the exemption.

To complain about


139. 26 Cong. Rec. 6872 (June 27, 1894) (statement of Sen. Hill). "The whole controversy this morning arises, not over the lack of exemption per se of a corporation, but over the exemption which is claimed for individuals who do not have more than $4,000 income." Id. at 6873 (statement of Sen. Hill).

140. Id. at 6866.

141. Id. Earlier in the year, Rep. Benton McMillin of Tennessee, a member of the House Ways and Means Committee, explained why the Committee did not give corporations an exemption similarly:

The corporation pays upon all its net income. And why? We will give you our reasons for it.

Here are artificial parties; here are creatures of the law that have peculiar privileges. They have in some instances the right of eminent domain; they have the right to sue and be sued as individuals.

A Member. The right to go to the courts.

Mr. McMillin. Yes; the right to go to the courts. They have the right to be exempt from personal liability. As the Government has to keep its courts in existence for the benefit of many of these corporations, as all or a majority of them are presumed to be founded upon surplus, we have thought that an exception might be made in their case, and that the exemption need not apply


Interestingly, in response to this statement, Rep. Lacey queried whether the Committee had taken into account the fact that many corporations would switch back to partnerships. Id. McMillin responded that the Committee had not taken that into consideration; if corporations wanted to disincorporate, that was their option. Id.
small stockholders of corporations being made to pay a tax is irrelevant, he stated, because "[w]e do not deal with the stockholders. We deal with a corporation as a legal being, doing business, artificially created, receiving protection upon its property from the General Government like citizens receive protection upon theirs." Senator Hill's response to this argument was that corporations are created for the benefit of shareholders and "the theory of the bill should be to treat all citizens alike and not discriminate against those having corporate investments." In other words, Hill looked through the corporate entity and saw a mere aggregation of individuals. He then went on to state that if corporations were "injurious to the country," the remedy was revocation of the corporate charter.

This linkage of sentiments about the goodness of corporations and their taxability pervades the debate, indicating that the role of corporations in society and corporate regulation was an underlying concern in the tax legislation. This is particularly obvious in the discussions regarding exemptions of small corporations, which were seen as the equivalent of partnerships, and large corporations, which were seen as a different species, which could (and perhaps should) be regulated. For example, Senator Allison of Iowa favored a corporate exemption not just to eliminate unfairness to individual shareholders with income below the exemption amount, but because the "small corporations [should] not be disturbed at all by this army of taxgatherers," and should be on a par with partnerships which did not pay tax.

Another theme raised in the tax debate that was also raised in the corporate regulation area was the issue of federalism. Did the federal government have the power to tax corporations that were franchised by the state? Senator Hill raised the issue starkly with his proposed amendment to

142. 26 Cong. Rec. 6866 (June 27, 1894). Senator Vest stated: "Senators may talk about citizens, about widows, for instance, who have their all in these corporations. We do not deal with them. We deal with corporations as artificial beings, whether large or small." Id. at 6867.
143. Id. at 6873.
144. Id.
145. Congressman Teller, agreeing that a corporation was "a proper subject for an income tax," seemed to do so reluctantly seeing it as the only way to tax the large corporations. Id. at 6870. See also id. at 6872 (Sen. Hill on the reality and merits of corporations); id. at 6874 (Sen. Higgins wondering if the provision is part of the "general cry against corporations," and asserting that the Senate must distinguish between "certain overgrown, bloated corporations, which make an unfair and unjust use of the quality of corporate power"—notably Standard Oil, "the great octopus," and the sugar trust—and other corporations); id. at 6879 (Sen. Allison distinguishing between large and small corporations).
146. 26 Cong. Rec. 6833 (June 26, 1894) (statement of Sen. Hale) ("It is the fashion now instead of making a partnership to form these little associations and put in twenty-five, forty, or fifty thousand dollars. They ought to be encouraged rather than discouraged.").
147. Id. at 6833 (June 26, 1894).
148. See also id. at 6834 (Sen. Hale stating that little corporations "take the place of small partnerships" and are excluded from the tax).
exempt from the tax any corporation created by a state which paid tax to the state on its earnings, dividends or franchise.\textsuperscript{149}

The 1894 Act also dealt with the issue of publicity of returns which became a major issue in 1909. The allegedly inquisitorial nature of the income tax had been an issue since the Civil War statutes. In his annual report for 1864, the Commissioner of Internal Revenue had stated:

\begin{quote}
In order that it may not be felt to be inquisitorial in its character, the instructions issued by this office required that the returns of income shall not be open to the inspection of others than officers of revenue. Some doubt having been entertained whether a proper construction of the law sustains the instructions, I recommend that the doubt be removed by express enactment.\textsuperscript{150}
\end{quote}

While the 1864, 1865 and 1866 Acts remained vague on this issue, the 1870 Act specifically provided that no government employee "shall permit to be published in any manner such income returns, or any part thereof, except such general statistics, not specifying the names of individuals or firms, as he may make public, under such rules and regulations as the commissioner of internal revenue shall prescribe."\textsuperscript{151} Section 34 of the 1894 Act revised section 3167 of the revised statutes to provide that no government employee could disclose information contained in returns, except as provided by law.\textsuperscript{152}

These themes of corporate entity, federal-state relations and publicity all emerged again in the debates in the Corporate Excise Tax of 1909. Meanwhile, amidst much sound and fury, the 1894 income tax was ruled unconstitutional in \textit{Pollock v. Farmers Loan & Trust Co.}\textsuperscript{153} in 1895 on the grounds that taxes on real and personal property were direct taxes which had to be apportioned among states by population according to article I, section 2, clause 3 of the Constitution.

The next major revenue need, occurring during the Spanish-American War, was met in 1898 through non-income tax provisions, including an excise tax, measured by gross receipts, on "every person, firm, corporation, or company [with gross receipts exceeding $250,000] carrying on or doing the business" of sugar or petroleum refining or owning or controlling any pipeline.\textsuperscript{154} This provision was a concession by Senate Republicans to

\textsuperscript{149} 26 Cong. Rec. 6883 (June 27, 1894); see also id. at 6621 (June 21, 1894) (Sen. Hill questioning whether the federal government can tax and therefore destroy instrumentalities of the state).

\textsuperscript{150} Report of the Commissioner of Internal Revenue for the Year Ending June 30, 1863, at 183-84 (1864), quoted in E. Seligman, supra note 107, at 439.

\textsuperscript{151} Act of July 14, 1870, ch. 255, § 11, 16 Stat. 256, 259.

\textsuperscript{152} Act of Aug. 27, 1894, ch. 349, § 34, 28 Stat. 509, 557.

\textsuperscript{153} 157 U.S. 429, reh'g granted, 158 U.S. 601 (1895).

\textsuperscript{154} Act of June 13, 1898, ch. 448, § 27, 30 Stat. 448, 464. The Act also included a tax on legacies. Id. § 29, at 464.
Democrats and populists who had wanted a general excise tax on corporate franchises of .25% of gross receipts of large corporations, as well as a response to the mass outrage at the accumulation of wealth and power by the Standard Oil Co. and the Sugar Trust.155.

The income tax issue, though seemingly quiet after the Pollock decision, was actually in "sub-surface ferment,"156 and in the years immediately before 1909 began to reach boiling point. The Democratic Party platform for the presidential election of 1908 supported an income tax; the Republican platform was silent on the issue.157 Taft, in accepting the Republican candidacy in Cincinnati on July 28, 1908, stated that a constitutional amendment was unnecessary for an income tax.158 The real campaign issue in 1908, however, was tariff reform, not the income tax.159 Proponents of tariff revision favored it for a variety of reasons including reasons connecting the tariff question to the trust issue. This argument held that high tariffs helped lead to the creation of trusts.160 Some felt that consumer prices were too high because of the tariff and, like President Taft, favored a reduction, especially on products that were "necessities."162

155. S. Ratner, supra note 107, at 233. The Republicans refused to yield on the income tax issue in part because they did not want the Supreme Court to have to overturn itself and thereby confirm criticism of the Court. Id.


157. Id. For other studies of the events leading to the passage of the sixteenth amendment, see J. Buenker, The Income Tax and the Progressive Era (1985); S. Ratner, supra note 107.

158. R. Blakey & G. Blakey, supra note 156, at 23. Roosevelt, in his 1907 annual message to Congress, had stated that he thought that both an income and an inheritance tax should be part of the federal tax system. After noting the difficulties of an income tax, he stated: Nevertheless, a graduated income tax of the proper type would be a desirable feature of Federal taxation, and it is to be hoped that one may be devised which the Supreme Court will declare constitutional. The inheritance tax, however, is both a far better method of taxation, and far more important for the purpose of having the fortunes of the country bear in proportion to their increase in size a corresponding increase and burden of taxation.

Second Annual Message, 42 Cong. Rec. 71 (1907).

159. R. Blakey & G. Blakey, supra note 156, at 23.

160. See, e.g., Tarullo, supra note 82, at 289. President Roosevelt stated, however, that the growth of large corporations was due to "natural causes," not tariffs. First Annual Message (Dec. 3, 1901), reprinted in 15 Messages and Papers of the Presidents 6641, 6645.

161. Tarullo, supra note 82, at 289.

162. Taft Would Reduce Tax on Necessities, N.Y. Times, Mar. 30, 1909, at 2, col. 1. The Times noted that some in the Republican Party feared that too heavy a tax on necessities might cause the women "to persuade the men to vote out of power the party responsible for the increased prices." Taft Approves Bill for an Income Tax, N.Y. Times, Mar. 25, 1909, at 1, col. 1 (the article is subtitled "Women's Influence Feared"). The article notes that after the McKinley tariff bill raising prices on necessities, the Republicans were voted out because "[t]he women of the country were against the Republicans." Id. As Speaker Reed explained it, the women heard from store clerks that the cause of increased prices was the McKinley bill. The women "went home and told their husbands and fathers and their stories had a tremendous effect at the ballot box." Id.
Taft had favored downward tariff revision for several years.\textsuperscript{163} In his inaugural address on March 4, 1909, Taft called for a special session of the 61st Congress, to convene March 15th, to deal with tariff reform and with the revenue need reported by the Secretary of the Treasury.\textsuperscript{164} If tariffs could not provide enough revenue, he suggested that an inheritance tax should be enacted.\textsuperscript{165} By April, 1909, the dissident or "insurgent" Republicans had revolted against the tariff and several income tax bills had been introduced into the Senate. Enough Republicans had joined the Democrats in support of the income tax that passage in the Senate of an income tax appeared likely.\textsuperscript{166}

The traditional view of the Corporate Excise Tax of 1909 focuses on the tax's role in the passage of the income tax. This view sees the suggestion of the Corporate Excise Tax by President Taft on June 16, 1909, in a message to Congress,\textsuperscript{167} as one half of a political compromise (the other half being the proposed sixteenth amendment) to postpone the passage of an income tax until the adoption of a constitutional amendment authorizing the income tax.\textsuperscript{168} It is certainly true that Taft was against an income tax act for political reasons: he did not want a vote on it to split the Republican party, and he did not want the Supreme Court to be in the position of either having to reverse itself (and thus impugn its authority) or to uphold

\begin{itemize}
\item \textsuperscript{163} Letter from William Howard Taft to Horace Taft 1-5 (June 27, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497).
\item \textsuperscript{164} The 1908 Report of the Secretary of the Treasury showed that the economic depression had produced a deficit. R. Blakely & G. Blakely, supra note 156, at 24. Sereno Payne of New York, Chair of the House Ways and Means Committee, estimated that about $20,000,000 was needed to make up the deficit. 44 Cong. Rec. 194 (Mar. 23, 1909). President Taft, in his inaugural address of March 4th, stated that expenditures exceeded revenues by $100,000,000. N.Y. Times, Mar. 5, 1909, at 4, col. 1.
\item \textsuperscript{165} Taft Wants Tariff on Revenue Basis, N.Y. Times, Mar. 5, 1909, at 4, col. 1.
\item \textsuperscript{166} See, e.g., R. Blakely & G. Blakely, supra note 156, at 32-36; J. Buenker, supra note 157, at 98-108. The various income tax bills treated corporations differently. On April 15, Sen. Bailey introduced an income tax bill that was practically identical to the 1894 Act, which imposed a tax of three percent on net income in excess of $5,000 on individuals and corporations. See R. Blakely & G. Blakely, supra note 156, at 30. On April 21, Sen. Cummins proposed a tax plan similar to Bailey's except that it was graduated and did not tax corporations because a corporate tax put too much of a burden on shareholders (especially small ones) as opposed to bondholders. 44 Cong. Rec. 1420 (Apr. 21, 1909). On May 18, the insurgent Republicans and the Democrats agreed on a compromise bill that taxed both individual and corporate incomes at a flat rate; a rebate prevented double taxation of income individuals received from corporations. N.Y. Times, May 19, 1909, at 1, col. 1.
\item \textsuperscript{167} Message from the President, 44 Cong. Rec. 3344.
\item \textsuperscript{168} E.g., S. Ratner, supra note 107, at 291 (The reasons given for the Corporate Excise Tax were all "flimsy rationalization."); id. at 288 (The real reason for the Corporate Excise Tax was to defeat the income tax.). Much contemporary opinion agreed. E.g., 44 Cong. Rec. 4383 (July 9, 1909) (statement of Sen. Clark of Missouri) ("[I]n my humble judgment this corporation tax was cooked up for the purpose of defeating the proposition for an income tax."); 44 Cong. Rec. 4725 (July 31, 1909) (statement of Rep. Underwood) (The Corporate Excise Tax is a "weapon to defeat an honest income tax that would equalize the burdens of taxation on all the people.").
\end{itemize}
its prior decision and face the wrath of the public.\textsuperscript{169} However, Taft’s support of the excise tax was substantive as well as political. The tax furthered his goal of corporate regulation. This substantive interest in a corporate tax preceded his political interest in the tax caused by the spring 1909 threat of immediate passage of the income tax. While other commentators have noted Taft’s positive endorsement of such an act,\textsuperscript{170} none has given the Act and Taft’s support of it the attention it deserves as an expression of the period’s concern over corporate regulation (especially capital structure and issuance of stock) and the debate concerning the nature of the corporate entity. The next section addresses these omissions.

III. THE CORPORATE EXCISE TAX OF 1909

A. Background to the Passage of the Act

By 1909, both federal and state governments had applied a wide variety of taxes to corporations.\textsuperscript{171} On the federal level, corporations had paid excise taxes based on gross receipts, paid taxes on dividends and interest paid and, under the 1894 income tax law, paid taxes on net earnings. To some extent, which is not entirely clear (as discussed previously), these last two taxes were seen simply as collections at the source. The proper taxation of corporations was difficult to obtain. To tax income to the corporation and then to the shareholder was, to many, a double tax. While corporations were recognized as separate legal entities, questions remained:

Should the corporation’s property be made the basis of taxation to the corporation itself, or to the stockholders alone, or to both? Obviously a tax on the corporation is really a tax upon its stockholders, for otherwise than as a matter of legal reasoning a corporation and its stockholders are one. Hence the question of whether both the corporation and the stockholders shall be taxed is an interesting problem in double taxation.\textsuperscript{172}

Although corporations and their stockholders were really one, corporations were also a special class of entities “composed of artificial entities

\textsuperscript{169} J. German, \textit{supra} note 54, at 201; see also J. Buenker, \textit{supra} note 157, at 108.
\textsuperscript{170} J. Buenker, \textit{supra} note 157, which began in the 1960s as a doctoral dissertation, is rare in its fairly lengthy exploration of Taft’s (and Root’s and Wickersham’s) support of the Act, especially the publicity feature, as a positive piece of legislation. See id. at 108-12.
\textsuperscript{172} Id.
created by the state and enjoying special privileges," and therefore sometimes, appropriately, subject to special rules. Moreover, when only corporations were to be taxed, the problem should, theoretically, have been simpler. Yet, as will be seen, the Corporate Excise Tax raised troubling issues.

In his inaugural speech, Taft had suggested an inheritance tax be enacted if a tariff failed to provide sufficient revenue. Nevertheless, he had at that time also been considering some type of a corporation tax and had proposed the inheritance tax because his attorney general, George W. Wickersham, had not yet drafted a corporate tax bill at the time of the inauguration. Wickersham, however, shortly thereafter drafted a series of corporate provisions which Congressman Longworth of Ohio presented to the House Ways and Means Committee later in March before the tariff bill was presented to the full House. This occurred, according to Taft, because after the House abandoned a proposed tax on coffee and tea (for fear it would be too unpopular) a substitute revenue measure was needed:

The Speaker and I then conferred as to what kind of a tax we ought to substitute for the coffee and tea tax, and the Speaker asked me whether it was not possible, in accordance with one of my speeches, to introduce a form of income tax; and I said that it was on corporations, and that I would direct the Attorney General to prepare a law, or sections of the law, creating such a tax on dividends. He did so, and the Speaker went before the Ways and Means Committee and urged its adoption, but they declined to consider it at the time.

175. J. Buenker, supra note 157, at 94.
176. 44 Cong. Rec. 4002 (July 1, 1909) (Sen. Root tracing the history of Taft's support of the corporate tax); 44 Cong. Rec. 4717 (July 31, 1909) (Rep. Longworth states that he presented the bill at the President's request).
177. Letter from William Howard Taft to Horace Taft (June 27, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497). I could not locate the draft of the law to which he refers, but I did find a memo from Taft to the Secretary of the Treasury, Franklin MacVeagh, in which Taft asks for revenue estimates on a bill which "at the instance of the Speaker, [Taft had] prepared tentatively for insertion in the tariff bill." Letter from William Howard Taft to Franklin MacVeagh (Mar. 15, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 495). Presumably, this is the corporate tax, but the bill was not enclosed.

In July, Sen. Root told the Senate that he had seen the paper Rep. Longworth presented to the Ways and Means Committee in March; the draft was the corporate excise tax under consideration in July with a few changes, and "it bore upon its face corrections in the handwriting of the Attorney-General and blanks filled in the handwriting of the President." 44 Cong. Rec. 4002 (July 1, 1909).
Two versions were considered: one taxing dividends, the other taxing net earnings. As to either version, some saw a corporate tax as double tax, either in the sense that corporations already paid state taxes, or in the sense that a holding company would pay a tax when it distributed dividends to its shareholders on earnings already taxed when its operating companies distributed dividends to it. Representative Sereno Payne of New York told the House on March 23rd that the Committee had rejected a tax on the net earnings of corporations because many corporations were in a precarious financial condition (due to the Panic of 1907), states already taxed corporations, and the bill would not raise enough revenue. Congressman Longworth, speaking in July after the introduction of the corporate excise bill, stated that the Committee had rejected the proposal because it did not think the revenue was needed and also because the Committee had decided already to propose an inheritance tax, as suggested by Taft at his inauguration. At any rate the revenue bill that the House sent to the Senate for consideration consisted of the tariff provisions plus an inheritance tax but not a corporate tax.

While other commentators have dismissed this early interest of Taft in the corporation tax as being not very sincere, given his endorsement of the inheritance tax, I believe that their dismissal of his interest is colored by the traditional focus on the income tax. First, this traditional view ignores, or at least devalues, the consistent attention Taft gave to a corporate tax from the beginning of his presidency; although he favored an inheritance tax first, he consistently mentioned a corporate tax as an alternative. Second, and perhaps more importantly, when viewed in the context of his concern about regulation of corporations, Taft's March exploration of the issue, his June introduction of the tax and vigorous support of its publicity features appear not simply as a political compromise to stave off the income tax and a break in the Republican party but, in addition, as a logical means to attain his goal of corporate regulation without undue federal interference.

As previously stated, Taft favored some type of federal regulation of corporations, but seemed ambivalent both about the exact nature of the regulation and the degree to which he would support it. Being more conservative than Theodore Roosevelt, Taft was more sensitive to concerns

178. See, e.g., Tax on Corporation is Planned by Taft, N.Y Times, Mar. 23, 1909, at 1, col. 1 (bill "now in course of preparation" will levy a tax of two percent on dividends of corporations except certain ones such as banks).
181. 44 CONG. REC. 194 (Mar. 23, 1909).
182. 44 CONG. REC. 4717 (July 31, 1909).
183. J. German, supra note 54, at 231-44 (especially at pp. 236-37).
about excessive federal power. Moreover, federal incorporation proposals were complicated by the states' rights issue of whether the federal government was interfering with the states' sovereign power to incorporate corporations. The corporation tax, in particular its publicity feature, was an ideal way to achieve very mild control given the complications of federal incorporation and Taft's and Congress' ambivalence towards federal regulation.

Given the difficulty Congress experienced in dealing with the antitrust issue and the constitutional question involved in federal incorporation, a corporate excise tax provided an easy entry into federal corporate regulation. First, taxation, unlike incorporation, was an acknowledged federal function. While objections might be made (and, as will be seen later, were made) to taxing corporations as an encroachment on state taxing prerogative, there was some precedent for dual state and federal taxation. In 1900 the Supreme Court had affirmed the right of the federal government to impose an inheritance tax even though states also taxed inheritances. Second, there was some basis in tax history (the aborted 1894 Act) and in contemporary legal theory to identify corporations as taxable entities. Moreover, the publicity feature, which Taft claimed was the most important feature of the Act, also fit in with the spirit of the times: it was a common feature of attempts to regulate corporations as well as a general feature of the Progressive Era. The information obtained through publicity would further other governmental goals. For example, as previously stated, tariff reform was a major issue of the 1908 campaign and was in fact the major focus of the 1909 bill. In order to make proper decisions regarding tariffs, more information was needed, and the publicity feature of the corporation tax could help provide it. Publicity would also provide information that would allow Congress to make informed decisions about antitrust laws.

184. See, e.g., id. at 236 (Taft states that the bill drafted by Attorney General Wickersham meets the concern of those "who fear too great concentration of power in the Federal Government").
185. Federal incorporation was less likely to violate states' rights if it was voluntary, but then the question became what incentive there was for corporations to voluntarily comply with the federal law. See, e.g., id. at 234.
187. E. Seligman, supra note 107, at 515.
188. J. German, supra note 54, at 203 (Taft stating that the publicity feature was the most significant, especially since the Act would bring little revenue); see also Letter from William Howard Taft to Horace Taft 9 (June 27, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497); Letter from William Howard Taft to Frederick Fish (June 28, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497); Letter from William Howard Taft to E.G. Buckland, Vice President, N.Y.N.H. & H.R.R. (July 17, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497).
189. See supra note 81 and accompanying text.
Some contemporaries saw the tax as a first step in Taft's program to supervise corporations—the next step being a federal incorporation bill. Others more cynically felt that Taft never had any intention of enacting a corporate supervisory system. The tax was simply an expedient way to forestall the income tax, or perhaps it was a method of fulfilling his campaign pledge to carry out Roosevelt's policy regarding corporations, but in a way so mild that it was possibly more hype than reality.

Taft himself, in a lengthy letter written on June 27, 1909, laid out his position on the corporate tax, the tariff, and the income tax. First, the letter, as does the rest of his correspondence for that summer, shows that his primary concern is the passage of a tariff with downward revisions in rates. Second, it is also evident that he saw the tax not only as a political compromise, but also as a positive measure to help implement his agenda for corporate regulation. His chronology of events mentions the tax proposed in March but really begins with the Senate rejecting the inheritance tax provision passed by the House on the grounds, according to Taft, that since states already taxed inheritances, a federal tax would be a "double tax" and therefore possibly "oppressive." Taft then suggested to Senator Aldrich, as a means to make up the revenue, the corporation tax, for which he "had expressed [him]self a number of times in favor of such a corporation income tax." Aldrich rejected the tax because he believed the Treasury had enough of a surplus to cover the deficit. Taft even spoke to Senators Borah and Cummins, who both favored an income tax, about the corporation tax stating that he favored the corporation tax, despite being for an income tax "in theory," because he believed the Supreme Court would most likely rule an income tax unconstitutional in order to remain consistent with its prior ruling in Pollock. Taft recounted that when Senators

190. See supra notes 51-54 and accompanying text.
191. Taft Planned Tax on Roosevelt Lines, N.Y. Times, June 24, 1909, at 1, col. 1 (Taft sees the tax as carrying out Roosevelt's policy as he pledged to do in his campaign).
192. Letter from William Howard Taft to Horace Taft (June 27, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497). Taft states that he wrote the letter "for the purpose not alone of informing you, but of putting in permanent form, so to speak, for my own use, my state of mind at the present moment as to the political situation." Id. at 1.
193. Id. at 1-3.
194. Id. at 6. Taft disagreed with this view because he felt the state taxes were not heavy. Id.
195. Id. at 7
196. Id. Besides Taft, others feared embarrassing the Court by forcing it to decide once again the constitutionality of an income tax act. E.g., 44 Cong. Rec. 3941 (June 29, 1909) (Sen. Dixon supported an income tax but "I respectfully and earnestly commend the embarrassment that would follow either a favorable or an unfavorable decision by the Supreme Court.").
197 Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895). Letter from William Howard Taft to Horace Taft 7 (June 27, 1909) (Papers of William Howard Taft, Library of
Cummins and Bailey obtained a coalition of Democrats and Republicans sufficient to pass an income tax, Senator Aldrich came to him and accepted the compromise of a constitutional amendment for an income tax and the passage of a corporation tax. Originally, Aldrich wanted the tax to last only two years (to cover the years of deficit revenue), but Taft insisted on no limitation because he did not think he "could break up the nineteen Republicans, or get support from the people from whom it was necessary to get support, if that limitation was in."\textsuperscript{198} Thereupon Aldrich withdrew his opposition to no limitation and Wickersham proceeded to draft a bill.\textsuperscript{199} So far, this accounting fits in with the standard view concerning the introduction of the corporate excise tax, although Taft clearly indicates early support for it. The letter's next sentence, however, plainly shows Taft's support for this tax extended beyond political expediency; he viewed the tax as a means to further his agenda for regulation of corporations:

The things that were required in the Bill were two: First, the tax as an excise tax upon corporations, [for the tax to pass constitutional muster] and, second, a certain degree of publicity with reference to the returns. \textit{That publicity gives a kind of federal supervision over corporations, which is quite a step in the direction of similar reforms I am going to recommend at the next session of Congress} \textsuperscript{200}

The remainder of this Part will focus on this non-tax element of the Corporate Excise Tax: the tax as part of the efforts at corporate regulatory control and as an expression of legal theories of corporate personality. In

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\textsuperscript{198} Letter from William Howard Taft to Horace Taft 8 (June 27, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497).

\textsuperscript{199} Id. at 9.

\textsuperscript{200} Id. (emphasis added). His corporate agenda is contained in the "plan which I outlined in my Letter of Acceptance and in my Inaugural Address, and which is outlined in the platform—it is with reference to the amendment to the anti-trust law, the amendment to the interstate commerce law, and a general carrying out of the Roosevelt policies" \textit{Id. at 11-12; see also Taft Planned Tax on Roosevelt Lines, N.Y. Times, June 24, 1909, at 1, col. 1} (Taft sees the corporate tax as carrying out Roosevelt's policy as he pledged to do in his campaign; once the tax is passed, Taft can "go straight at the main provisions on his programme" in December.).

In a June 28, 1909 letter, Taft wrote:

The men who are in favor of this [corporate] tax are not in favor of disturbing business, but they are in favor of putting it on as sound a basis as possible, and one of those bases is publicity where there is the enjoyment of such a franchise as that which exempts men from the ordinary general liability of partners.

Letter from William Howard Taft to Frederck Fish 1 (June 28, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497).
particular, I will focus on the publicity feature, and to a lesser extent, the interest and dividend provisions and the exemption amount since these most reflect the non-tax aspects.

B. Discussion Prior to Passage: June 16, 1909 - August 5, 1909

On June 16, 1909, President Taft sent a message to Congress recommending an amendment to the Constitution to permit an income tax and proposing an excise tax on all corporations measured by a two percent tax on a corporation’s net income.\(^{201}\) He called the tax "an excise tax upon the privilege of doing business as an artificial entity and of freedom from a general partnership liability enjoyed by those who own the stock."\(^{202}\) As authority for the tax he cited Spreckels Sugar Refining Co. v McClain,\(^{203}\) which had upheld the 1898 excise tax on all persons, associations and corporations engaged in certain businesses.\(^{204}\) In his message Taft specifically mentioned as an advantage of such a tax the federal supervision of the annual accounts and business transactions of all corporations which would result from enforcing the tax. While acknowledging the usefulness of corporations, he stated:

> If now, by a perfectly legitimate and effective system of taxation, we are incidentally able to possess the Government and the stockholders and the public of the knowledge of the real business transactions and the gains and profits of every corporation in the country, we have made a long step toward that supervisory control of corporations which may prevent a further abuse of power.\(^{205}\)

In this message Taft clearly stated his support of the tax not simply for its revenue-raising potential, but also for its regulatory functions. It is important to note that he saw regulation as coming not just from the federal government, but also through private market control by giving stockholders and the general public access to information.

This message was referred to the Senate Committee on Finance\(^{206}\) and deliberations in the Senate started June 25th.\(^{207}\) The bill, as presented,
provided for a "special excise tax with respect to the carrying on or doing business" on all corporations and associations "organized under the laws of the United States, or of any State or Territory" with capital stock represented by shares. The rate of tax would be two percent of net income in excess of $5,000. Net income was to be computed by subtracting from gross income dividends received from other corporations that paid the tax and all "ordinary and necessary expenses," depreciation, losses and "interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation .. outstanding at the close of the year."

The Commissioner would determine the exact form of the returns, but the law provided that the form should include: (1) paid-up capital stock, (2) total amount of debt at the end of the year, (3) gross income, (4) dividends received from owning stock of other corporations, (5) expenses, (6) losses, (7) interest actually paid, not exceeding paid-up capital stock, (8) taxes paid and (9) net income. All returns would "constitute public records and be open to inspection as such."

The bill passed both houses in essentially the form in which it was introduced. Debate occurred on two levels: The first level was theoretic and dealt with the wisdom and constitutionality of the tax; the second level looked at specific provisions. Debates on the secondary level focused mainly on four features: exemption amount, interest deductions, dividend deductions and publicity—features which involved the theoretic aspects and which had given the drafters the most trouble. These secondary issues will be discussed in the context of the larger theoretic issues they illustrate.

208. 44 Cong. Rec. 3836 (June 25, 1909). These provisions were reflected in § 38 of the tariff act. Act of Aug. 5, 1909, ch. 6, § 38, 36 Stat. 11, 116.
211. One change was the decrease in the rate from two percent of net income to one percent. Act of Aug. 5, 1909, ch. 6, § 38, 36 Stat. 11, 116.
212. Legislative history, other than congressional debates, is frustratingly sparse. That which follows, though full of holes, is the best I could discover after extensive research. In the fall of 1989 I spent one week at the Library of Congress and the National Archives researching the Corporate Excise Tax with disappointing results. After much searching, the Archives librarians could discover no official history, drafts of the bill, committee hearings or reports. They did locate, and I read, the various petitions to Congress concerning the Act. I have incorporated into this Article relevant information found in this material. I then went to the Manuscript Division of the Library of Congress to read the papers of two principal players in the drafting of the Act: William Howard Taft and Elihu Root. In addition, I read the papers of two secondary players: Sen. Aldrich and Secretary of the Treasury Franklin MacVeagh. Unfortunately, the papers of the principal drafter, Attorney General George W Wickersham, are scattered across the country, none being at the Library of Congress. Therefore, I read none of his private papers, except to the extent that they are included in somebody else’s papers, such as Root’s. In addition the Library of Congress does not hold all of Root’s
On July 1st Senator Elihu Root of New York, who was intimately involved in the drafting of the corporate tax, gave a lengthy speech in support of the tax. The speech serves as a good vehicle to explore the main theoretical issues involved in the debate over the tax. First, he dealt with the constitutionality of the tax. This issue had several facets. At the outset, he asserted the constitutionality of the excise tax in contrast to the unconstitutionality of the income tax proposals.\textsuperscript{213} This statement was necessary given the strength of congressional support for the income tax and the feeling that the excise tax was just a ploy to defeat it. Next, he asserted the constitutionality of the excise tax by referring to various Supreme Court precedents which, he claimed, supported three propositions: (1) the legality of the federal government imposing an excise tax measured by profits, as opposed to an income tax, (2) the constitutionality of imposing an excise tax only on corporations for the privilege of doing business and (3) the constitutionality of the federal government taxing corporations franchised by the states.\textsuperscript{214}

Root principally relied on the same case President Taft had mentioned in his June 16th address: \textit{Spreckels Sugar Refining Co. v. McClain}.\textsuperscript{215} Since much debate occurred concerning the meaning of the case, and the debate raised important issues concerning the nature of corporate personality and states’ rights, a closer look at the case and the debate is warranted. The \textit{Spreckels} case upheld the 1898 statute imposing an excise tax, measured by gross receipts, on every person, corporation or firm engaged in certain businesses, namely refining sugar or petroleum.\textsuperscript{216} Two critical differences between the 1898 Act, upheld by the Supreme Court, and the proposed corporate excise tax were, as some congressmen pointed out,\textsuperscript{217} (1) the latter...
The proposed tax singled out corporations as the subject of the tax whereas the 1898 Act had taxed any corporation or individual engaged in the enumerated businesses. Root's response to the first difference was that the tax was on the privilege of doing business, not on profits and therefore was an excise, not an income tax. The second difference between the two provisions raised two other basic issues: whether Congress could single out corporations from other enterprises engaged in the same business, and even if one type of business could be singled out from the others for special taxation, whether such a singling out of corporations interfered with the states' right to control corporations.

The first issue involved the nature of the legal personality of corporations. If corporations were somehow different from individuals or partnerships engaged in the same business, then there was a basis for distinguishing between corporations and others engaged in similar occupations. President Taft himself in his message to Congress noted the distinctiveness of corporations and used it as the basis for taxing only them: "This is an excise tax upon the privilege of doing business as an artificial entity and of freedom from a general partnership liability enjoyed by those who own stock." Senator Root reiterated the advantages of limited liability as a basis for distinguishing between corporations and others and added two other features of corporate form as bases for the distinction: continuous life and easy transferability of interests.

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218. 44 Cong. Rec. 4016 (July 1, 1909). An excise tax is defined as follows:
A tax imposed on the performance of an act, the engaging in an occupation, or the enjoyment of a privilege
Tax laid on manufacture, sale, or consumption of commodities or upon licenses to pursue certain occupations or upon corporate privileges. In current usage the term has been extended to include various license fees and practically every internal revenue tax except the income tax. Black's Law Dictionary 506 (5th ed. 1979).

In Flint v. Stone Tracy Co., 220 U.S. 107, 150 (1911), the case upholding the Corporate Excise Tax, the Supreme Court stated that, due to extensive precedent on the subject, "It is unnecessary to enter upon an extended consideration of the technical meaning of the term 'excise.'" 220 U.S. 107, 150 (1911). The only definition it gave was a quotation: "Excises are 'taxes laid upon the manufacture, sale or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges.'" Id. at 151 (quoting T. Cooley, A Treatise on the Constitutional Limitations 680 (7th ed. 1903)).

219. 44 Cong. Rec. 3344 (June 16, 1909) (emphasis added); see also 44 Cong. Rec. 4036 (July 2, 1909) (statement of Sen. Davis on the advantages of limited liability).

220. 44 Cong. Rec. 4006 (June 16, 1909).
Opponents, both in and out of Congress, refused to recognize these differences as a basis for differing treatment of two firms—one a corporation and one a partnership—engaged in the same business. Senator Brandegee saw no difference between corporations and partnerships; they "are both combinations of men to do business." He stated that whether a corporation was an "individual" was a question that he "want[ed] a little time to consider." When asked whether he recognized that there was "a great deal of difference in the extent of the liability of members of partnerships and members of corporations," he admitted the difference and then queried whether the taxation of partnerships had also been considered by the Committee. This "unfair" discrimination against corporations vis-a-vis partnerships was one of the complaints commonly recited in various corporate petitions to congressmen concerning the tax. There was even

221. E.g., 44 Cong. Rec. 4026 (July 2, 1909) (statement of Sen. Cummins); 44 Cong. Rec. 4028 (July 2, 1909) (statement of Sen. Brandegee); 44 Cong. Rec. 3757 (June 24, 1909) (Sen. Newlands) (stating Spreckels is not on point, and then moving to tax gross receipts of every person or corporation); 44 Cong. Rec. 4036 (July 2, 1909) (statement of Sen. Bristow); 44 Cong. Rec. 4365 (July 9, 1909) (statement of Rep. Townsend of Michigan) ("I can see no reason why a corporation should be taxed while a partnership or individual doing the same kind of business, with an equal amount of capital and as great earnings, is permitted to escape."). But see, e.g., 44 Cong. Rec. 4036 (July 2, 1909) (Sen. Davis responding to Sen. Bristow that Bristow ignores the limited liability of shareholders).

Some pointed out that the unfairness lay in reaching only the wealth of those who had incorporated but not the wealth of those held in partnership or other form. E.g., 44 Cong. Rec. 4229 (July 7, 1909) (statement of Sen. Dolliver); see also 44 Cong. Rec. 4025 (July 2, 1909) (Sen. Borah, who favored an income tax, asked why the tax was not extended to partnerships, if it was a tax on carrying on business. Senator McCumber responded that it could have been, but it "was thought best" not to extend it.).

222. 44 Cong. Rec. 4028 (July 2, 1909).

223. Id.

224. Id. (question by Sen. Curtis).

225. Id.

226. E.g., Collar and Shirt Manufacturers' Association Petition to Senate Finance Committee (June 30, 1909) (Petitions to Senate Finance Committee regarding Corporate Tax, Record Group 234, Sen. 61A-K6, National Archives); see also Letter from E. Conway (Chicago manufacturer of pianos and organs) to Secretary of the Treasury Franklin MacVeagh (June 30, 1909) (Franklin MacVeagh Papers, Library of Congress, Manuscript Division) ("All our small manufacturers and merchants must be on an equal footing with their competitors or go out of business.").

In a long letter to Sen. Root outlining the evils of the proposed tax, a Wall Street lawyer named Charles Mathewson listed as flaws the taxing dividends and the limitation on interest deductions. Mathewson also complained of the inequity of taxing a corporation but not a partnership engaged in the same business. Letter from Charles Mathewson to Elihu Root 2-3 (June 25, 1909) (Elihu Root Papers, Library of Congress, Manuscript Division). He then suggested a stamp tax instead. Id. at 3. Root's response was that the choice was between an income tax or the corporation excise tax, not between the corporation tax and a stamp tax or no tax. Letter from Elihu Root to Charles Mathewson (June 26, 1909) (Elihu Root Papers, Library of Congress, Manuscript Division). This response illustrates the difficulty of determining intent. It can be read as either indicating a cynical approach to the tax (i.e., to prevent the much worse income tax) or as a politically astute attempt to gain support for the tax by appealing to the complainant's fears (support this or something worse will pass). See also
talk of corporations dissolving into partnerships because of the tax.\textsuperscript{227} Other opposition was phrased in natural entity terms. Under this theory it was illegal to tax corporations, which "have all the powers and privileges of natural persons," without taxing other natural persons.\textsuperscript{228}

The use of theories of corporate personality (or, in modern language, theories of the firm) in the tax debate was complex. An artificial entity theory used by proponents of the tax also permitted these proponents to look through the entity (since it was artificial) to the owners. Thus, Senator Root could argue, in an attempt to gain support of pro-income tax senators, that the tax was a tax on unearned wealth,\textsuperscript{229} and Congressman Longworth could argue that the tax was like the English tax, a tax at the source.\textsuperscript{230} But relying on an artificial entity theory to reach individuals meant only certain individuals—those who availed themselves of the corporate form—would be taxed. The pro-income tax group noted this, stating that the tax ignored certain wealth, especially interest income, while taxing small businessmen who utilized corporations.\textsuperscript{231} Thus, income tax opponents often used an aggregate theory to oppose the tax because they wanted to tax all wealth via an income tax. Under a pure aggregate theory, owners of businesses—whether they are partnerships or corporations—would be taxed.

\textsuperscript{227} E.g., Letter from E. Conway to Sen. Cullom (June 28, 1909) (Franklin MacVeagh Papers, Library of Congress, Manuscript Division) ("We certainly will have to surrender our charter and do business as co-partners if it [passes]."); \textit{Making a Mistake at Washington}, 109 \textit{Leslie's Weekly} 1 (July 1, 1909) (John Sleucher, President of the Publisher, Judge Co., sent this "forthcoming editorial" to Root in a letter of June 22, 1909). This complaint—or threat—was reiterated right after the passage of the Act. \textit{See The Federal Corporation Tax Law, 1 Corp. Tr. Co. J. No. 13 (Supp. Nov. 1909)} (pages unnumbered). In actuality few corporations dissolved. \textit{Further Developments Regarding the Federal Corporation Tax, 1 Corp. Tr. Co. J. No. 16 (Jan. 1910)} (pages unnumbered).

\textsuperscript{228} \textit{The Federal Corporation Tax Law, supra} note 227.

\textsuperscript{229} 44 \textit{Cong. Rec.} 4006 (July 1, 1909) (taxing only wealth concentrated in corporations, the tax achieved "the great object of the income tax").

\textsuperscript{230} 44 \textit{Cong. Rec.} 4719 (July 31, 1909) (the tax "taxes the income received by the stockholders, not in their hands, but at its source, namely, upon the income of the corporation").

\textsuperscript{231} E.g., 44 \textit{Cong. Rec.} 4038 (July 2, 1909) (statement of Sen. Cummins). The argument about not taxing bondholders appears again as a criticism of the interest deduction. \textit{E.g.}, 44 \textit{Cong. Rec.} 4006 (July 1, 1909).
on the business income. This is somewhat ironic since a populist income tax advocate would also support regulation of corporations for antitrust purposes and such regulation would find support in an artificial entity theory.

An attempt to resolve the conflict between two goals (income tax and corporate regulation) and two different theories appears in the exemption and publicity debates. In these debates, there was a recognition of an essential distinction between large and small corporations.

The original bill, containing no exemption provision, taxed all corporations on all income. However, in a letter dated June 17th, Attorney General George Wickersham suggested an exemption of $25,000 "analogous to the exemption of small incomes in the income tax law of 1894." This comment is somewhat disingenuous since the 1894 Act, after extensive debate, provided exemptions for individuals but not for corporations. Despite Wickersham's suggestion, revisions of the draft bill as late as June 21st did not provide any exemption. However, by the June 22nd revision a handwritten insertion of a $5,000 exemption was in place.

There appear to be three reasons why people favored an exemption for small corporations, however defined. Each is connected with one of the major objections to the corporate tax: (1) the conceptual difficulty of distinguishing between partnerships and small corporations (a problem still with us today), (2) a states' rights issue and (3) a belief that only large corporations needed federal regulation.

The first reason has been explored in the discussion of legal personality. Nothing more need be said other than to state that exempting small corporations would blunt the criticism of unfair discrimination against corporations because those corporations most similar to partnerships were small ones and under an exemption provision they would not be taxed. Senator Daniel stressed this reason in his proposal to exempt corporations with capital stock not exceeding $300,000 since "ordinary" partnerships did not exceed this amount; thus, corporations with less than this amount should be treated as partnerships; those with more capital "enter into a different class and come under different views." He stated that one of the "striking" differences between a corporation and a partnership was that partnerships were natural persons whereas corporations were "purely a


233. Revision of June 22 (June 22, 1909) (Elihu Root Papers, Special Subject labelled Corporation Excise Tax, Library of Congress, Manuscript Division). I do not know whose handwriting is on the draft; it may be reasonable to assume it is Root's since the draft is found in his papers.

234. 44 CONG. REC. 4237 (July 7, 1909).
CORPORATE TAX ORIGINS

fiction of the law; an artificial creation; a figment only out of the brain of man.”

Whether the federal government had the power to tax corporations was a much discussed issue. Since corporations were both franchised and taxed by the states, many saw the Corporate Excise Tax as an infringement of states’ rights. The issue was heightened because, as will be discussed below, the proposed bill was seen not merely as a tax but as the beginnings of federal control of corporations as President Taft had stated in his message to Congress. Thus, as Congressman Underwood stated, “I think there has been no more dangerous proposition [than this tax] ever presented to those . . . who believe in the sovereign power of the state government.”

In response to President Taft’s and others’ allegations that the corporation ought to pay for the privilege of being a corporation, Congressman Pickett, for example, admitted that this was so, but that the privilege being granted by the state ought to be taxed by the state. If there were a federal incorporation law for corporations engaged in interstate commerce, he continued, then it would be proper for the federal government to tax those corporations. As it stood, however, it was “an invasion of the rights that properly inhere in the States” for the federal government to impose the excise tax on the privilege of doing business as a corporation. While Pickett viewed taxing purely intrastate corporations as violating state sovereignty, Senator Rayner disagreed on the basis, ultimately upheld by the Supreme Court, that imposing a tax on corporate businesses was not the kind of vital state power the federal government could not tax.

An exemption provision would help meet the states’ rights objections in the sense that small corporations, largely engaged in intrastate business, would not be covered by the tax while large corporations which were

235. Id. Daniel stated that there were at least five important differences. The other differences were that a partner generally goes under his own name whereas a corporation does not, limited liability, perpetual life and a common seal for a corporation and, finally, corporations “may be as migratory as any bird of the air,” organized in one state and doing business in another whereas a “partnership is fixed; it has a fixed residence according to its own place of business and according to the status of its members.” Id. Note that these other differences occur because the corporation is artificial.

236. 44 Cong. Rec. 3344 (June 16, 1909) (“Another merit of this tax is the federal supervision which must be exercised in order to make the law effective over the annual accounts and business transactions of all corporations.”).

237. 44 Cong. Rec. 4725 (July 31, 1909).

238. 44 Cong. Rec. 4395 (July 12, 1909).

239. Id., see also 44 Cong. Rec. 4027 (July 2, 1909) (Sen. Elkins of West Virginia questioning the constitutionality of taxing corporations formed under state law); The Federal Corporation Tax Law, supra note 227 (quoting from the president of the Department of Taxes and Assessment of New York City, that the tax “encroaches upon the powers of the states”).

engaged in interstate commerce, a proper subject of federal governmental powers (though the exact extent was unclear) would be covered. Obviously, an exemption phrased in terms of dollar amounts (as the proposals were) rather than type of commerce, would be somewhat over- and under-inclusive, but a bright-line test would be more easily administered than an inquiry into the nature of the business engaged in.

The $5,000 exemption also met to some extent the objection that if corporations needed regulation, it was only the large corporations, and not the small ones, which were similar to partnerships. This attempt to assuage the small corporation advocates was important because several of the other provisions—those concerning interest, dividends and publicity—were seen as detrimental to small corporations while not sufficiently attacking the problem of large corporations.

The tax treatment of dividends received from other corporations was problematic in the 1909 corporate tax bill (and continues to be so today).241 If dividends are taxed, then income which has been earned only once would be taxed several times as it wended its way through the many layers of corporate structure. Depending on who bears the incidence of the corporate tax (whether it is shifted in whole or in part to consumers and/or wage earners), taxation of intercorporate dividends can be seen as multiple taxation of one person.242 If corporations are consistently seen as separate legal entities, it would logically follow that each corporation should be taxed on all income it receives, including dividends. Whether this makes economic sense is another question given the uncertainty of where the incidence of the tax lies. In 1909 not only was the incidence of the tax unclear (although some congressmen believed that it ultimately fell on the consumer)243 but so was the nature of the corporate entity. It is not surprising, then, that the subject of whether to include in income dividends received from corporations which were subject to the tax was an issue.

The corporate tax bill, as introduced in the Senate, excluded from a corporation's income dividends received from corporations which were subject to the tax. Earlier drafts, however,244 had included dividends, and


242. The incidence of corporate taxation is not at all clear. See id. at 18-19; C. McLure, MUST CORPORATE INCOME BE TAXED TWICE? (1979). During the 1909 debates, some congressmen believed that the tax was borne by the consumers in the form of higher prices charged by the corporation. See, e.g., 44 CONG. REC. 4422 (July 12, 1909).

While taxing intercorporate dividends may result in multiple taxation, a dividends exclusion or deduction may result in a windfall to some persons. Mundstock, supra note 241, at 18-42.

243. E.g., 44 CONG. REC. 3941 (June 29, 1909) (statement of Sen. Dixon); 44 CONG. REC. 4422 (July 12, 1909).

244. The June 17th draft included dividends received; by the June 21st draft they were excluded from net income as they were in the draft presented to the Senate on June 25 (though the drafts continued to play with the language). Revision of June 17th (June 17, 1909) (Papers of Nelson W. Aldrich, Library of Congress, Manuscript Division, Reel 34).
discussion of the issue occurred in both congressional debates and correspondence. The discussion focused more on the validity of holding companies than on the revenues that taxing dividends would produce. The controversy concerning the treatment of dividends was heightened by its connection to the issue of the legitimacy of holding companies, the very corporations seen as the most abusive (being the method by which trusts and monopolies were produced) and the most in need of regulation. President Taft himself was against holding companies.

Senator Clapp argued strongly for the taxation of dividends received. Without such taxation holding companies, whose incomes consisted largely of dividends, would be exempt from the tax; yet he believed these were the very corporations which ought to be taxed since they embodied the corporate traits people feared. "You talk about the power of great aggregations of capital; you talk about the crushing out of the life and of the rights and of the opportunities of the individual ..." On the other hand, some

245. Herbert Knox Smith, the head of the Bureau of Corporations, prepared a thirteen page memorandum at the request of Attorney General George W Wickersham on corporations owning stock of other corporations. Smith divided these corporations into six categories: simple holding companies (only function is to hold stock); companies combining holding function with the direct operation of plants; companies whose stock holdings are chiefly in subsidiary companies which carry on a distinct, though related, business; companies whose chief business is the direct operation of plants and properties; companies holding stocks primarily for the purpose of investment and not for the purpose of control (this large category primarily includes banks, insurance companies and other investment companies); and holding companies, the subsidiary companies of which are also holding companies. Herbert Knox Smith, Memorandum on Corporations Owning Stocks of Other Corporations (July 26, 1909) (Elihu Root Papers, Library of Congress, Manuscript Division). Wickersham’s cover letter of July 26, 1909, to Root indicates that Wickersham is sending the memo to Root because of Root’s request for some information on holding companies (the specifics of which are unidentified in the letter). Smith states that four companies, Standard Oil, U.S. Steel, American Tobacco and Central Leather would produce a little more than $1 million if a one percent tax applied to dividends. Id. This amount would be “a very substantial proportion of the total revenue derivable from the taxing of holding companies in the industrial group[,]” only $2 million being derived from other industrial holding companies and other industrial companies. Id. Public utilities, mining companies, etc., would produce $1 million and railroad companies would produce $2.3 million. Id. at 17. If revenues from dividends paid on stock held for investment only and not control were included, the total revenue from taxing dividends would range from $8 to $11 million. Id. at 18.

246. E.g., Tenth Annual Message, 45 Cong. Rec. 378, 380 (Jan. 7, 1910) (proposing that railroads subject to the Interstate Commerce Act not be permitted to hold stock in any corporation which competes with it); id. at 383 (corporations choosing to incorporate under his proposed voluntary measure could not hold stock in other corporations without approval because the holding company “has been such an effective agency in the creation of the great trusts and monopolies”).

Senator Clapp believed that the dividend exemption, by offering “immunity from taxation,” actually encouraged the formation of holding companies, which were “great, powerful, overshadowing, absorbing industries, absorbing industrial life and industrial affairs.” 44 Cong. Rec. 4010 (July 1, 1909).

247. 44 Cong. Rec. 4010 (July 1, 1909). On July 7, Sen. Clapp introduced an amendment taxing all dividends received. 44 Cong. Rec. 4229 (July 7, 1909). In addition, Sen. Clapp
Senators and large corporations believed that taxation of dividends at each level in the corporate structure would be vastly unfair (as well as expensive) regardless of the merits of holding companies because it was "unjust" to stockholders of holding corporations to pass a law "retroactive in effect." Moreover, such a tax would be double taxation because it would tax twice money earned but once. One response to this criticism was the entity theory. A corporation which owned 100% of a subsidiary corporation and whose sole income consisted of dividends from that corporation could rightfully be taxed on those dividends even though the subsidiary had already paid tax on the income used to pay the dividend because a "corporation is a separate entity with a different relation to the subject matter [the income]." But the argument raised for taxation of dividends even more frequently than the entity argument was a corporate regulation argument: holding companies were in general not good and should be discouraged or forbidden.

This hostility to large corporations and a feeling that they needed regulation runs through the entire debate on the corporate tax. I have shown these sentiments in the discussion of exemptions for small corporations as stated that even if taxing dividends was "double taxation" as some claimed, that was acceptable since the tax was an excise tax rather than an income tax. Senator Newlands also spoke out against what he saw as an exemption for holding companies which "hold the stock of other companies for the purpose of monopolizing production." Senator Bailey agreed with Cummins on the need to tax especially holding companies. Note that both Bailey and Cummins strongly supported an income tax. But even the Attorney General seemed to hold the holding company in disfavor. Charles MacVeagh, General Solicitor for the United States Steel Corporation, had written him that in calculating the amount of interest deduction for holding companies one should "take the entire net income of the holding company and its subsidiary companies and deduct from that income (first) the interest payable upon the bonds of the subsidiary companies; and (second) the interest upon all the bonds issued by the holding company except those issued in exchange for such bonds of the subsidiary companies as were kept alive and included in the credit given under (first)." Letter from Charles MacVeagh to George W Wickersham (June 29, 1909) (Elihu Root Papers, Library of Congress, Manuscript Division). Actually, this letter is a clarification of a letter sent to Wickersham on June 26th. Wickersham had responded to that letter by stating that such a provision was not possible:

_I think the strong tendency of the time is to discourage rather than to encourage holding companies. The abolition of holding companies would practically prevent any large trusts or monopolies being formed; while, of course, such companies having been organized under provisions of law inviting such organizations should not be disenfranchised as it were yet it does seem to me that no encouragement should be extended towards [sic] their further formation or growth, and I feel quite confident that no such provision as you suggest would stand any chance of passing the Congress._


249. 44 Cong. Rec. 4231 (July 7, 1909) (Sen. Aldrich stating that the exemption for dividends was designed to prevent double taxation).

well as in discussion of the dividend issue. On the exemption issue, the small corporate interests largely won, although they still had to file returns. The large corporate interests won on the major issue of dividend exclusion: in the Act as passed, corporations were permitted to deduct dividends received from other corporations. However, on two other issues large corporations did not do so well. They lost on the publicity issue and achieved only a compromise on the interest provision.

Like the dividend issue, the treatment of interest was an issue in 1909 and remains one today. Whether an interest deduction should be allowed had been, according to Senator Root, "the subject of repeated discussion in which the President, the Attorney-General, and other members of the Cabinet and members of the Committee on Finance of the Senate took part." The June 17th draft contained no interest deduction. However, by June 21st there was in place the provision which was ultimately enacted allowing a deduction for interest on an amount of corporate indebtedness equal to the amount of paid up capital stock. It will be remembered that one of Taft's major concerns, and a major concern of the time, was stock watering or overcapitalization. A tax law denying interest deductions would further the goal of preventing such overcapitalization by discouraging debt; at least two commentators saw this goal as the purpose of the provision.

Many congressmen opposed an interest deduction on the grounds that it encouraged corporations to substitute debt for equity and thereby avoid the tax. Senator Root's response to this was that the limitation on interest deductions was enacted to prevent excessive conversion. Some questioned the taxation of interest payments on the ground that it was really double taxation of shareholders in that dividends would be reduced by the amount

251. 44 Cong. Rec. 4007 (July 1, 1909).
253. R. Blakey & G. Blakey, supra note 156, at 46. In the 1916 congressional debates on the income tax, Rep. Hull stated that the original theory in the 1909 Act on the limitation on interest deductions was to prevent shifting from stock to debt and to prevent the use of watered stock. The issuance of debt would result in avoiding the real purpose of the law. 53 Cong. Rec. 10,656 (July 8, 1916). Hull was then asked whether this limitation was still necessary in 1916 since individuals now paid tax on interest received, unlike in 1909. Hull vaguely responded that a corporation is not allowed the same interest deductions as individuals "in view of the manner in which it was organized and its superior business advantages." Id.
254. E.g., 44 Cong. Rec. 4007 (July 1, 1909) (conversation between Sens. Root and Bacon). This argument has a familiar ring. See Rudnick, supra note 138, at 975 n.16 (hearings and press commentary on leveraged buyouts).
255. 44 Cong. Rec. 4007 (July 1, 1909). Senator Bacon responded that even with the limitation some conversion of stock to debt was possible, and he cited the steel example. 44 Cong. Rec. 4062 (July 2, 1909).

In Flint v. Stone Tracy Co., 220 U.S. 107, 173 (1911), the Supreme Court stated that the interest limitation "may have been inserted with a view to prevent corporations from issuing a large amount of bonds and thereby distribut[e] profits so as to avoid the tax." Whatever the reason for the provision the Court felt that the limited deduction was valid. Id.
of tax on interest paid. Others, looking through the corporate entity to the individual owners, felt that it was unjust to tax dividends but not to tax the unearned wealth held in the form of bonds. Still others felt that there ought to be no interest deduction. One reason for this belief was that many small corporations had no debt and therefore the limited deduction worked to their disadvantage in comparison with large corporations which did have debt or could convert equity to debt.

Another reason seems to have been a belief that interest should not be deductible in arriving at income. Although the 1894 Act had allowed both individuals and corporations to deduct interest payments, there was some confusion as to whether corporations, being artificial entities, should be able to deduct interest. The noted tax expert Edwin Seligman in his 1911 treatise stated:

> From the economic point of view there is a distinction between individual income and corporate income. In the case of individuals, true taxable property consists in the surplus above indebtedness. Net income can therefore be arrived at only by deducting interest on debts. But in the case of corporations the matter is somewhat different. Capital stock represents in many cases only a portion of the property, the remainder being represented by the bonded indebtedness. It is stocks and bonds together that represent the property and the earning capacity of the corporation; and for this reason the most advanced tax laws in America, as well as in Europe, permit an individual to deduct his indebtedness or interest on his debts, while the corporation is assessed on both bonds and stock, or both on interest and dividends.

Thus, Seligman concluded that the 1894 income tax, which allowed corporations to deduct interest, "was really not a corporate income tax, but only a tax on corporate profits over and above fixed charges."

The fourth provision around which much debate revolved was that concerning publicity. This debate did not stop with the enactment of the tax but continued after, leading eventually to a dramatic revision of the provision. This prolonged discussion is not surprising given the pivotal role

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256. 44 Cong. Rec. 4007 (July 1, 1909); see also R. Blakey & G. Blakey, supra note 156, at 46.
260. E. Seligman, The Income Tax 513 (1911); see also 53 Cong. Rec. 10,656 (July 8, 1916) (Rep. Hull stating that a corporation is not entitled to the same interest deduction as an individual due to "the manner in which it was organized and its superior business advantages").
261. E. Seligman, supra note 260, at 513. Seligman noted that an argument could be made that this was not "so serious" since individuals included interest in their income. Nevertheless, he stated that such a definition of income was "uneconomic." Id.
publicity played in corporate regulatory theory and consequently in the enactment of the tax.

C. Publicity and Control of Corporations

In the Progressive Era, as discussed previously, a wide spectrum of public opinion (from the President on down) believed in publicity or access to information. Thus, from the very inception of the corporate tax, the publicity feature was a key element. It was the instrument whereby government would acquire information about corporations; acquiring information was the first step towards supervision. President Taft sounded this note in his June 16th message to Congress in which he proposed the tax:

Another merit of this tax is the federal supervision which must be exercised in order to make the law effective over the annual accounts and business transactions of all corporations... If now, by a perfectly legitimate and effective system of taxation, we are incidentally able to possess the Government and the stockholders and the public of the knowledge of the real business transactions and the gains and profits of every corporation in the country, we have made a long step toward that supervisory control of corporations which may prevent a further abuse of power.262

Accordingly, the earliest drafts of the bill provided that all returns, "together with any corrections thereof which may have been made by the Commissioner, and all documentary evidence and notes of testimony taken and filed in connection therewith, shall constitute public records and be open to inspection as such[.]")263 But in the June 17th draft, reference to evidence and notes was crossed out, presumably by Senator Root.264 This pared-down version was enacted as paragraph six of the final tax.265 The June 17th draft also followed section thirty-four of the 1894 tax and provided that it was illegal for any employee of the government to make known "in any manner whatever not provided by law to any person any

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262. 44 Cong. Rec. 3344 (June 16, 1909). Taft's response to Boston lawyer Frederick Fish who complained of the publicity feature was: "I do not in the least agree with you as to the publicity which will follow the tax. I think that is a good thing, and it is one of the reasons why I favor the tax." Letter from William Howard Taft to Frederick Fish (June 28, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497). See also Letter from William Howard Taft to E.G. Buckland, Vice President, N.Y. N.H. & H.R.R. Co., Providence, R.I. (July 17, 1909) (Papers of William Howard Taft, Library of Congress, Manuscript Division, Reel 497); 44 Cong. Rec. 4720 (July 31, 1909) (Rep. Longworth stating that publicity will help stockholders prevent abuse).

263. Revision of June 17th at 4-5, sent with cover letter from Elihu Root's secretary to Sen. Nelson Aldrich (June 17, 1909) (Nelson W Aldrich Papers, Library of Congress, Manuscript Division, Reel 34). This was apparently the second draft sent on that date.

264. Id.

information obtained by him in the discharge of his official duty[.].”266 To do so was a misdemeanor punishable by a fine or imprisonment.267 By June 21st the draft prohibited a federal employee from making “known in any manner any document received, evidence taken or report made, under this section except upon the special direction of the President.”268 This became the language of paragraph seven of the Act.269 These two sections, and the federal supervision they symbolized, were the subject of much debate and commentary before enactment of the tax and were the focus of protest after enactment.

Senator Root, in his explanation and defense of the tax, echoed President Taft’s enthusiasm for the publicity feature; Root, however, emphasized only publicity to the government. The Act would provide the government with annual information which would “show the course and progress of the business of every corporation of the United States organized for profit.”270 In this respect he aligned himself with those Progressives calling for more scientific government: such annual information would allow the government to “take a great and a necessary step forward to the more efficient and creditable performance of the duties it has undertaken and that are imposed upon it under our constitutional system.”271 Thus, while he did not support passing taxes with “ulterior” purposes, Root believed that if the tax provided “incidental” benefits such as this tax did, then that was a reason to vote for the tax.272 The government regulated interstate commerce, passed tariff laws and regulated the currency, but it did so without adequate information. This provision would, he stated, provide the government with the necessary information.273 He acknowledged that since the provision applied to all corporations, it would reach the relatively few corporations which engaged in none of the activities that Congress regulated; nevertheless, information regarding these corporations was needed:

A full and satisfactory knowledge of the field into which a legislative body is to enter is not accomplished by including only the things that come within its necessary action. The whole field should be before us, and we should be able to form some judgment as to the relative amounts,

267. Id.
270. 44 CONG. REC. 4006 (July 1, 1909).
271. Id.
272. Id., see also 44 CONG. REC. 3760 (June 24, 1909) (Sen. Newlands stating that it is permissible to regulate businesses via the taxing power).
273. 44 CONG. REC. 4006-07 (July 1, 1909); see also 44 CONG. REC. 3759 (June 24, 1909) (Sen. Newlands stating that the tax will provide information for scientific legislation).
the relative capacities for answering to taxation, the trade relations between these corporations with which we are most closely concerned, and the other corporations of the country. 274

Root acknowledged that there would be "certain incidental publicity to others than the Government." 275 Although he did not seem to recognize the merit of this as Taft did, he implied it by stating that corporations had "estopped themselves from saying that they ought not to have their business inquired into, for the very basis of corporate life is freedom from personal liability for debt and the confinement of the creditor, the person who does business with the corporation, to the corporate assets." 276 In other words, the limited liability feature of corporations gave the public, or at least the creditor, some right to know the affairs, and therefore the assets, of the corporation.

While Root, like Taft, believed that a primary good of the tax was the information it provided the government and the public, others vociferously fought the tax primarily because of that very provision. 277 The original provision, which had made public all statements concerning the tax, was horrendous: "The hairiest Populist . . . would have thought [that provision] most likely a reporter's invention." 278 The provision that was actually proposed made public only the actual return and left to the discretion of the President whether other statements should be published. Even this more moderate proposal was too dangerous:

The calm-minded, just, well-poised gentleman who is now President of the United States might safely be trusted with this immense power. We have had several Presidents, however, who were impulsive, subject to fits of violent temper, vindictive, and we shall have no doubt other such Presidents. It will be in their power to injure or destroy their enemies by directing the publication of the sworn statements filed under this law. 279

The provision was offensive because it could provide information not simply to the government but also to the general public. The New York Times, for example, editorialized that the disclosure of earnings and other

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274. 44 Cong. Rec. 4007 (July 1, 1909).
275. Id.
276. Id., see also 44 Cong. Rec. 4719 (July 31, 1909) (Rep. Longworth stating that it is not inquisitorial to look into the affairs of corporations; there is a difference between looking into the affairs of individuals and those of corporations).
277. J. Buenuker, supra note 157, at 117, states that most of the protests about the tax concerned the record keeping and disclosure features. The correspondence to Sens. Root and Aldrich which I read, as well as the petitions to Congress, lead me to agree that these were highly protested features. The other provision greatly complained about was that requiring use of the calendar year instead of the fiscal year. See infra note 294. This provision was amended later. Since the calendar year is of a more technical nature than the publicity issue, I will not deal with it.
279. Id. The Times is obviously referring to Roosevelt.
information might lead to bankruptcy if creditors became aware of a corporation’s shrinkage in business and called in debt. Small corporations, in particular, worried about large corporations obtaining information about them that would hurt their competitiveness.

Frequently, however, the reason for complaint was government, not public, access to information. Corporate representatives swarmed to Washington in June to object not to the tax as a tax but to the provision to “supervise them, the so-called ‘publicity’ features.” The New York Times screamed that the measure was “[h]alf-muckrake and half money-scoop .... [and thus] one of those hybrids abhorred by nature and disliked by man.”

The Times believed that the muckraking feature of the bill, its publicity feature, was the primary goal because otherwise a “simple” stamp tax would have raised the necessary revenue. The real purpose of the bill,
according to this view, was supervision and control of corporations and not revenue. While Theodore Roosevelt sought national control of corporations through federal licensing, Taft sought supervisory control through the corporate tax. This was bad enough as to large corporations, but totally unnecessary with respect to private corporations which did not abuse their corporate powers. Why should they be punished by a tax in order to get at other corporations which were abusive? The Times' protests were echoed by many others. (Only a few asked for more supervision.) Some even suggested that a tax on dividends should be instituted rather than on net income for the reason that a dividends tax would not be intrusive on the corporations.

The publicity feature, in sum, was the focus of protests by corporations primarily because it represented to them the first step toward federal supervision of corporations. In addition, the provision gave the general public information that many saw as potentially harmful. Finally, the discretionary power vested in the president to disclose further information was troubling in the amount of power it gave to the executive and the

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286. Editorial, Mr. Taft's Tax Bill, N.Y. Times, June 24, 1909, at 6, col. 1.
287. E.g., Petition from the Miller Brewing Company to Rep. William J. Cary (July 20, 1909) (Petition to House Ways and Means Comm. regarding Corporate Tax, National Archives, Record Group 233, HR 61A-H34.21); see also supra note 257 (containing President Taft's response to various complaints about publicity). Senator Gallinger of New Hampshire stated that he received several letters complaining about the tax creating "an army of agents and inspectors sent out by the Government to pry into the affairs of these corporations." 44 Cong. Rec. 3937 (June 29, 1909). Senator Flint of California stated that revenue agents could inspect corporate books only if the Commissioner was "satisfied" that a false return or no return had been made. Id. Thus, he believed that the corporations were protected from unnecessary prying while at the same time the federal government achieved some supervision of corporations and the general public, through the publicity features, would "be advised of the affairs of corporations throughout the country." Id. He believed there was, therefore, a balancing of public, governmental and corporate interests. Id.
288. E.g., 44 Cong. Rec. 4038 (July 2, 1909) (statement of Sen. Cummins, who was for the income tax); 44 Cong. Rec. 4230 (July 7, 1909) (Sen. Dolliver, with Sen. Dixon agreeing, that the publicity features needed to reach holding companies).
289. E.g., Letter from John D. Rockefeller to Sen. Nelson W Aldrich (June 21, 1909) (Nelson W. Aldrich Papers, Library of Congress, Manuscript Division, Reel 34). Rockefeller, on behalf of himself, his father and associates, thought it "would be vastly preferable" to have a tax on dividends rather than on net earnings. The net earnings measurement was objectionable because "[i]t would place the affairs of every corporation under inquiry, surveillance and espionage." Id. at 1. He also objected to the use of net earnings because (1) it created questions of salary, depreciation, etc., (2) all corporations would have to keep "uniform" accounts so that the tax could be imposed uniformly and (3) it would involve corporations and the government in "endless dispute and embarrassment." Id. Others suggested a tax on gross receipts, for the similar reason that such a tax would not require as much record keeping or disclosure, or result in as much dispute, as a tax on net income. J. Burek, supra note 157, at 118.
potential for using that power politically to appease the popular anti-corporation sentiment.290

D. Publicity After Enactment of the Statute

The corporate excise tax was enacted in August, 1909, but was not upheld by the Supreme Court until 1911.291 Between enactment and validation, opposition to the excise tax was immediate and well-organized. Various trade associations, individual corporations and even shareholders sent protests to Congress which were frequently form letters. Opposition followed lines similar to pre-enactment complaints: (1) the law discriminated against those doing business in the corporate form as opposed to those doing business as individuals or partnerships,292 (2) the law infringed upon states' rights293 and (3) the publicity provisions were unacceptable.294 As before enactment, the publicity feature was the major focus of protest. Given the widespread view that the main intent of the law was to supervise corporations and that the publicity provision was the instrumentation of that intent, it is not surprising that the section garnered so much attention. The remainder of this Article will focus on the publicity feature and attempt to evaluate what, if anything, it meant in terms of the era's attempts to regulate corporations.

290. The Times talks of "easily" finding pretexts to disclose information to appease the "mob of corporations teasers." Editorial, By Direction of the President, N.Y. Times, June 26, 1909, at 6, col. 1.


292. E.g., Petition from the Board of Trade, Portland, Maine (Jan. 14, 1910); Resolutions of the Board of Trade of New Brunswick (Feb. 9, 1910); Resolutions of the Providence (R.I.) Board of Trade (Jan. 25, 1909); Petitions to Senate Finance Committee (Record Group 129, National Archives, Sen. 61A-J24 RG 129); see also Petitions to the House Ways And Means Committee (National Archives, HR 61A-H34.21 No. 6479).

293. See Petitions to the Senate Finance Committee (Record Group 234, National Archives, Sen. 61A-K6 RG 234). On January 14, 1910, a group of corporations and commercial organizations met in Chicago "under the auspices of the Illinois Manufacturers' Association," and called for the repeal of the tax "as being at variance with established rights and principles, and especially as infringing upon the domain of the sovereignty of the various States, as discriminating between individuals operating as individuals and those operating through corporate bodies[.]" Reprinted in 45 Cong. Rec. 1467 (Feb. 3, 1910) (emphasis added) (Various groups from a variety of states signed the resolution.).

294. Another much discussed issue was the issue of calendar year reporting. Many protested that such a schedule was unfair. Eventually, the law was amended to permit fiscal years. Before enactment a group of prominent accounting firms in New York (including Price, Waterhouse, Haskins & Sells) had complained about the lack of a fiscal year and the failure to base income on amounts earned (not received) and expenses incurred (not paid). Letter signed by various accountants under a cover letter by Suffern & Son (July 23, 1909) (Papers of Nelson Aldrich, Library of Congress, Manuscript Division, Reel 35). The fiscal year issue was later fixed by amendment, but the method of accounting was taken care of by regulations.
The Act provided in paragraph three for the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, to prescribe the exact form of the tax return. Paragraph six stated that the returns, together with any corrections, were to be filed in the Commissioner's office and thereupon became public records "open to inspection as such." Under paragraph seven, no other document, evidence or report could be made public in any manner "except upon the special direction of the President."

The first set of regulations, issued December 3, 1909, were accompanied by a statement to the press from the Secretary of the Treasury, Franklin MacVeagh. The statement touched on several points, two of which are of interest for purposes of this Article: a statement concerning the purpose and interpretation of the Act and a statement regarding the publicity feature. The purpose of the Act, stated MacVeagh, was to produce

295. The law required that the form contain language setting forth, (first) the total amount of the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year; (second) the total amount of the bonded and other indebtedness of such corporation, (third) the gross amount of the income received during such year from all sources, also the amount received by such corporation within the year by way of dividends upon stock of other corporations subject to the tax imposed by this section; (fourth) the total amount of all the ordinary and necessary expenses actually paid out of earnings in the maintenance and operation of the business and properties of such corporation within the year, stating separately all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property, (fifth) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, (sixth) the amount of interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, (seventh) the amount paid by it within the year for taxes imposed under the authority of the United States or any State or Territory thereof, and separately the amount so paid by it for taxes imposed by the government of any foreign country as a condition to carrying on business therein; (eighth) the net income of such corporation.

296. Id. at 116.
297. Id.
299. Reprinted in The Treasury Department's Explanation of the Federal Corporation Tax Law, 1 Corp. Tr. Co. J. No. 15 (Special No.) (Dec. 13, 1909) (pages unnumbered) [hereinafter MacVeagh Statement]. MacVeagh made two other points. First, he stated that net income meant profits from business as well as other sources such as investments. In this regard he noted that "income" was used rather than the term "profits" because although the terms were "practically identical," income was "more embrasive." Id. His comments reflected the definition of gross income found in Regulations 31, art. 2, § 5, at 137.

MacVeagh's second point dealt with methods of accounting, as did Regulations 31, art. 2, § 5, at 137, which stated, "It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation for the year in which return is made." Id. Similarly, despite
revenue; the Act would be liberally construed to do so.\textsuperscript{200} This statement by itself is innocent, but given the furor surrounding the enactment of the Act and its purported supervisory purpose, this statement may be read as an attempt to assuage corporate fears of control. Nevertheless, a broad construction of the statute aided the supervisory purpose asserted by President Taft, if not by his Secretary of the Treasury. For example, while paragraph three of the statute required each corporation subject to the tax to submit a return, the statute’s language did not make clear whether corporations whose net income did not exceed the $5,000 exemption amount were “subject” to the tax and thereby required to file returns. The regulations resolved the ambiguity by stating that every corporation, except those specifically exempted, was required to file a return “whether it may have net income liable to tax or not.”\textsuperscript{301} The rationale for this interpretation was that it allowed the government to compute the tax.\textsuperscript{302} While this is true, it is not irrelevant that this interpretation also cast the broadest net and allowed the government to amass the most information on corporate business, in the manner desired by Senator Root.\textsuperscript{303} The issue was repeatedly litigated; the courts favoring the government interpretation.\textsuperscript{304}

the statutory language requiring that expenses be “actually paid within the year,” the regulations stated:

It is immaterial whether the deductions are evidenced by actual disbursements in cash, or whether evidenced in such other way as to be properly acknowledged by the corporate officers and so entered on the books as to constitute a liability against the assets of the corporation, joint stock company, association, or insurance company making the return.

Regulations 31, art. 4, at 139.

\textsuperscript{300} MacVeagh Statement, \textit{supra} note 299.

\textsuperscript{301} Regulations 31, art. 1, at 136. This issue apparently caused problems for some time. The Bureau of Internal Revenue received numerous inquiries on this issue and many of the failures to comply with the law were caused by corporations with income of less than $5,000 not filing returns. This interpretation conflicted with the 1894 income tax law which did not require individual taxpayers with income not exceeding $3,500 to file (all corporations had to file since they had no exemption amount).

\textsuperscript{302} 28 Op. Att’y Gen. 217, 220-21 (1912) (opinion issued in 1911). Wickersham stated:

The law in every respect is to be administered by the officers of the law and not by those who are subject to it. Efficiency of administration would be difficult, and even impossible, if the corporations could determine, each for itself, whether or not they were liable for any amount of tax, and make or withhold returns accordingly.

\textit{Id.} at 221. He cited as authority the 1898 tax which required all those involved in the specified businesses to file returns, regardless of the amount of gross receipts. \textit{Id.} at 218-19 (citing Act approved June 18, 1898, ch. 448, § 27, 30 Stat. 448, 464). In addition, he stated that under the 1894 income tax law, Act approved Aug. 27, 1894, ch. 349, 28 Stat. 509, although individuals with incomes of $3,500 or less did not have to file, \textit{id.} at 554 (the exempt amount was $4,000, \textit{id.} at 553), there was no exempt amount for corporations and every corporation, regardless of whether it had income, had to file. \textit{Id.} at 558.

\textsuperscript{303} See \textit{supra} notes 270-76 and accompanying text.

\textsuperscript{304} See, e.g., United States v. Acorn Roofing, 204 F 157 (E.D.N.Y. 1912); United States v. Military Constr. Co., 204 F 153 (W.D. Mo. 1913).
Several early Treasury decisions also liberally defined those organizations covered by the Act. In doing so, they broadened the revenue base, and additionally, by focusing on corporate characteristics, they contributed to the current debate on corporate personality. For example, a February 14, 1910 opinion of the Attorney General issued at the request of the Secretary of the Treasury stated that limited partnerships were subject to the Corporate Excise Tax.\(^{305}\) The partnership involved in the opinion was formed under Pennsylvania laws, issued certificates to its members, held real property in its own name, needed to sue or be sued in its own name, had perpetual life and centralized management and partners' liability was limited to the amount of capital subscribed to.\(^{306}\) Such an association, the opinion stated, fell within the definition of a corporation given by Mr. Justice Field in \(B. \& P \text{ R.R. Co. v. Fifth Baptist Church}\) (citation omitted) to wit: "Private corporations are but associations of individuals united for some common purpose, and permitted by law to use a common name, and to change its members without a dissolution of the association."\(^{307}\)

While this definition appears to be based primarily on the aggregate theory, the opinion later appeared to adopt an artificial entity theory of corporations. Quoting Justice Marshall in the \(Dartmouth College Case,^{308}\) the opinion stated that "[a] corporation is an artificial being, invisible, intangible, and existing only in contemplation of law."\(^{309}\)

The opinion concluded that a limited partnership fell within the scope of the tax because the law establishing the tax contained "no special requirements as to what powers this artificial person shall possess, the only essentials being that it shall be organized under a law, that its object shall be for profit, and that it shall have a capital stock represented by shares."\(^{310}\)

Shortly thereafter, on April 4, 1910, Internal Revenue Commissioner Cabell, on advice of the Attorney General, expanded the scope of the Act even more. He stated that organizations in Massachusetts and elsewhere known as "associates," "trusts" or "real-estate trusts," which were formed by agreement and declaration of trust rather than organized under a charter, were subject to the tax because the organizations were for profit and had "all of the essential elements of any joint-stock company."\(^{311}\) Those "essential" elements listed were the presence of certificates, the trading of certificates and the election of trustees.\(^{312}\) Here the Attorney General and


\(^{306}\) Id. at 190-93.

\(^{307}\) Id. at 193.


\(^{309}\) Id. at 636.


\(^{312}\) Id. at 51.
the Commissioner apparently overlooked the statutory language referring to corporations "organized under the laws" and focused on the characteristics of the association: certificates, transferability of shares and centralized management. Neither limited liability nor continuity of life were mentioned, though they had been in the February 14th Attorney General opinion. No explicit mention was made of the group's personality.

These two opinions created a broad interpretation of which associations were to be treated as corporations and thereby subject to the tax. Implicitly, as in the Massachusetts trust case, or explicitly, as in the limited partnership case, the basis of each decision was that the organization at issue was an entity separate from its members. A variety of characteristics indicated the separateness: limited liability, centralized management, continuity of life, free transferability of interests and the existence of shares.

In two 1911 cases the Supreme Court more clearly defined which entities were subject to the tax. Although the Court cut back somewhat on the Commissioner's expansive interpretation, it also focused squarely on the artificial nature of the entity. In *Flint v Stone Tracy Co.*, the case upholding the tax, the Court stated that the tax was an excise tax, not a direct tax, on the privilege of doing business in a corporate capacity with the advantages of doing business in such a form. These advantages, the Court said, were "obvious"—continuity of life, transferability of interests, centralized management and limited liability. Because such characteristics were so different from those of an individual, the Court stated that the tax was not unconstitutional in singling out corporations: "[I]t could not be said, even if the principles of the Fourteenth Amendment were applicable to the present case, that there is no substantial difference between the carrying on of business by the corporations taxed, and the same business when conducted by a private firm or individual."

In *Eliot v Freeman*, a companion case to *Flint*, the Court dealt with two Massachusetts trusts similar to those discussed by the Commissioner. Both trusts had centralized management by trustees and transferability of interests. However, neither had perpetual life in that each ended twenty years after lives in being. Moreover, the Court stated that unlike corporations, these trusts were not organized under the laws of a state, as required by the statute, at least not "within the ordinary meaning of [the] term..."
It then noted that the difference between joint-stock associations at common law and those organized under statutes was "well recognized" with statutory companies being like corporations, except for the absence of limited liability. The Court concluded that, since the trusts were not creations of the state, they "do not derive any benefit from and are not organized under the statutory laws of Massachusetts" and therefore were not subject to the corporation tax. Thus, the Court directly stressed the artificial, that is, legally created, nature of the corporation. The Supreme Court also stressed indirectly the artificial nature of corporations by focusing on only two characteristics as critical: limited liability and perpetual life. These two features were so critical because only artificial entities, those created by the state, could have them.

It is interesting to note that of the features listed by the Commissioner—limited liability, centralized management, transferability of shares, perpetual life and the existence of shares—the first four characteristics quickly became (and have remained) the touchstones of corporate status for tax purposes.

319. Id. at 186.
320. Id.
321. Id. at 186-87.
322. Section II(G) of the Revenue Act of 1913 imposed a tax on "every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships." Ch. 16, § II(G)(a), 38 Stat. 114, 172 (1913). This language also existed in the Revenue Act of 1916, ch. 463, § 10, 39 Stat. 756, 765, and the Revenue Act of 1917, ch. 63, § 10, 40 Stat. 300, 333. This language contrasted to the corporate excise tax language in the 1909 Act and later acts (e.g., Revenue Act of 1916, 39 Stat. 756, 789) which applied only to corporations "organized under the laws" of the United States. As I have shown, Elliot interpreted this "under the laws" language for the excise tax to mean that the corporation or association was created by statutory enactment. Elliot, 220 U.S. at 186. Hecht v. Malley, 265 U.S. 144, 153 (1924), stated that the same meaning must be given to the same language in the 1916 Act.

The income tax regulations did not expand on the definition, though they did specifically classify limited partnerships as corporations. Regs. No. 33 Art. 86 (1914) and Regs. No. 33 (Rev.) Art. 62. Some commentators believe that the inclusion of limited partnerships was based on Elliot which somehow implied the "organized under" language into the income tax law. See, e.g., C. BERGER & P WIEDENBACK, CASES AND MATERIALS ON PARTNERSHIP TAXATION 71-72 (1989). As support for this, they cite the fact that the 1918 regulations following the Revenue Act of 1918, which changed the "organized under" language to "created or organized in the United States," Revenue Act of 1918 § 1, 40 Stat. 1057 (1919), were amended to provide that limited partnerships would be corporations if the limited partnerships resembled corporations based on the characteristics of limited liability, transferability of interests and bringing suit in the firm's name. T.D. 2943, 1 C.B. 9 (1919).

I believe that these characteristics, particularly limited liability, were also important in the 1913 and 1916 classifications of limited partnerships as corporations, whereas the "organized under" language was not. First, even the 1913 regulation stated that it was "immaterial" how such corporations (defined in Art. 78 to include joint-stock companies and associations) were "created or organized." Regs. No. 33, Art. 79, at 58. The term included real estate trusts which distributed profits based on capital stock, or if no stock, capital invested. The 1918 regulations revised to cover the 1916 and 1917 Acts, were similar. Regs. No. 33 (Rev.), Arts. 57 & 58. Thus, for income tax purposes, all regulations, from the very first set, flatly stated that the manner of organization was unimportant. Thus, contrary to Berger and Wiedenbeck's
Although the emphasis on certificates has disappeared, the existence of shares was important under the 1909 tax for two reasons. First, given the state of flux that the legal theory of corporate personality was in, the presence of certificates served as a clear marker of a personality distinct from the owners of the certificates. If the association were not a separate entity, then shares would not exist. After all, people do not own certificates representing themselves.

Perhaps more important from the standpoint of the particulars of the tax was the need to know the capital of the association—capital which was represented by certificates. The tax, it will be remembered, limited interest deductions in order to help prevent stock watering or overcapitalization. A deduction was allowed only for interest on the amount of debt equal to the amount paid in capital. Since the capital was represented by certificates, it was logical to insist on the presence of certificates.

Certificates of ownership, and their manner of issuance, became an issue in another matter: the publicity provision. On December 3, 1909, in his opinion, the difference in wording between the income and excise tax provisions was clearly recognized. See Hecht, 265 U.S. at 153 (noting the marked contrast between the two). While it is true that Crocker v. Malley, 249 U.S. 223, 233 (1919), held that a Massachusetts trust was not an association, the basis for that decision was not the fact that the trust was not organized under any law. Stating that the manner of organization was immaterial, the Court nevertheless held that it "would be a wide departure from normal usage" to call the trust an association, basing its rationale on the fact that the purpose for taxing corporations on dividends received from other corporations was to prevent holding companies, and such a problem did not exist in this instance. Id. at 233-34. The Court in Hecht later pointed out that the Crocker decision needed "to be read in the light of the trust agreement there involved, under which the trustees were merely holding property for the collection of the income and its distribution among the beneficiaries and were not engaged in the carrying on of any business." Hecht, 265 U.S. at 160-61.

Secondly, article 57 of the 1918 regulations included in the definition of "corporation" "all business trusts organized or created for the purpose of engaging in commercial or industrial enterprises, the capital of which is evidenced by certificates or shares of interest issued or issuable to members on the basis of which profits are distributed or distributable." Regulations 33 (revised), T.D. 2690, 20 Treas. Dec. Int. Rev. 170 (1918). This language picks up the 1909 emphasis on the presence of certificates.

The premise of the 1909 law was the artificiality of the entity taxed. Thus, the interpretation of the law stressed those traits which evidenced that artificiality: limited liability and centralized management. However, because the tax was an excise tax, the language of the statute and the Supreme Court required a litmus test for this artificiality: creation by statutory enactments. Nevertheless, I believe it was these other traits or indicia of artificiality, rather than the statutory blessing of limited partnerships, that led to the 1913 regulations' absolute classification of these partnerships as corporations. The switch in 1918 to regulations that required an examination of the traits to see whether the limited partnership was like a corporation merely reflected, I believe, a decreased hostility to corporations and a less doctrinal, more sophisticated view of corporate personality.

Current regulations state that an unincorporated association will be classified for tax purposes as a corporation if it has three of the following four corporate characteristics: centralized management, continuity of life, free transferability of interests and limited liability. Treas. Reg. § 301.7701-2(a)(2) (as amended in 1983). These traits, of course, are the very ones highlighted in 1909.
press statement accompanying the issuance of regulations, Secretary MacVeagh had noted that he had received "[g]reat numbers of communications" concerning the publicity clause. Nevertheless, and despite the apparent inconsistency between paragraph six (which spoke of public records) and paragraph seven (which forbade disclosure except as provided by law or the president), MacVeagh stated that the language regarding filing and public inspection was so clear that the Internal Revenue Service had "no discretion whatsoever in the matter." The regulations themselves merely repeated word for word the statutory language without any clarification of the apparent inconsistency.

Nevertheless, at least as early as January, 1910, the Department of the Treasury indicated that "the extent of the publicity of such returns [was] . . . under consideration." This consideration was probably due to several factors. First, Secretary MacVeagh was not totally in favor of the publicity feature. In a letter to Congress on February 16, 1910, he stated that until Congress appropriated $50,000 to enable the Department of the Treasury to classify, index and exhibit the returns, he would not treat them as public records but as Internal Revenue documents open only to the inspection of the taxpayer, his representative or a person authorized by the President or the Secretary of the Treasury. More importantly, the complaints against the publicity feature were voluminous. While many people urged the total repeal of the tax, others complained specifically about the publicity feature. Many who demanded total repeal of the tax asked for the immediate abolition of the publicity provision pending total repeal.

Many of the complaints received by MacVeagh and Congress concerning publicity came from small corporations. These corporations feared that disclosure of information to competitors, particularly those doing business

323. MacVeagh Statement, supra note 299.
324. Id.
326. Letter from the Deputy Commissioner of Internal Revenue to G. Charles Horwood (Jan. 17, 1910) (Petitions to Internal Revenue, National Archives, RG 58, E171, No. 20258).
328. Further Developments Regarding the Federal Corporation Tax, 1 Corp. Tr. Co. J. No. 16 (Jan. 1910) (pages unnumbered) (protests were mainly against the publicity feature and calendar year reporting); see also 45 Cong. Rec. 1467-68 (Feb. 3, 1910) (reprinting the resolutions of a group representing various industries and organizations which met on January 14, 1910, under the auspices of the Illinois Manufacturers' Association asking for the total repeal of the tax and, pending repeal, the immediate abolition of the publicity feature; this was signed by many groups from many states). Various bills were introduced into Congress either to abolish the whole tax, e.g., H.R. 14545, 61st Cong., 2d Sess., 45 Cong. Rec. 139 (Dec. 14, 1909), or to amend the publicity feature, e.g., H.R. 17504, 61st Cong., 2d Sess., 45 Cong. Rec. 496 (Jan. 10, 1910). The text of these two bills may be found at 45 Cong. Rec. 1468 (Feb. 3, 1910).
as partnerships, would injure their businesses.\textsuperscript{329} Others feared that the big corporations would use the information provided by publicity to the "disadvantage of the less powerful."\textsuperscript{330} Many of these petitions stated that publicity for corporations whose stock was sold on an exchange or otherwise publicly offered (as through a newspaper) was acceptable, but that publicity "imposes an unjust and unreasonable burden upon mercantile and manufacturing corporations, whose stock is closely held and never offered for sale in the open market."\textsuperscript{331} These small corporations thought publicity "might apply, properly, to public corporations like railroads and industrial concerns, whose stocks and bonds are sought by the public, as it would enable investors to judge of the value of such securities."\textsuperscript{332}

This argument fits in with the concern of the times that overcapitalization and promoter schemes were due, in part, to the lack of information available to stockholders. It will be remembered that the rationale offered by President Taft for the tax when he introduced it in Congress was not just to provide the federal government with information, but also to give stockholders and the public access to information.\textsuperscript{333} If stock was closely held and never offered to the public, then the public did not need information, since the purpose of providing them with information was to allow them to make wise investments.

On February 17, 1910, Commissioner Cabell issued a directive to all Internal Revenue agents and collectors severely limiting, if not overruling, the public records provision of paragraph six which a few short months before Treasury Secretary MacVeagh had found so clear that the Internal Revenue had no discretion.\textsuperscript{334} Cabell stated that returns would not be open to general inspection but would be treated in the same manner as returns made under other revenue statutes.\textsuperscript{335} Substantial amounts of money would

\textsuperscript{329} Board of Trade of New Brunswick, Petition to the Senate Finance Committee (Feb. 9, 1910) (Petitions to Senate Finance Comm. regarding Corporate Tax, National Archives, Record Group 129, Sen. 61A-J24). The petitions appear to be forms or variants of forms as their language is similar. See Woonsocket Business Men's Association, Petition to Senate Finance Committee (Feb. 1, 1910) (Petitions to Senate Finance Comm. regarding Corporate Tax, National Archives, Record Group 129, Sen. 61A-J26); Business Men of Providence, Petition to Senate Finance Committee (Jan. 25, 1910) (Petitions to Senate Finance Comm. regarding Corporate Tax, National Archives, Record Group 129, Sen. 61A-J26).

\textsuperscript{330} Various corporations in Bloomington, Indiana, Petition to the Senate Finance Committee (Jan. 8, 1910) (Petitions to Senate Finance Comm. regarding Corporate Tax, National Archives, Record Group 129, Sen. 61A-J26).

\textsuperscript{331} Board of Trade, Portland, Maine, Petition to Senate Finance Committee (Jan. 14, 1910) (Petition to Senate Finance Comm. regarding Corporate Tax, National Archives, Record Group 129, Sen. 61A-J24).

\textsuperscript{332} Merchants Exchange of St. Louis, Missouri, Petition to Senate Finance Committee (Jan. 14, 1910) (Petition to Senate Finance Comm. regarding Corporate Tax, National Archives, Record Group 129, Sen. 61A-J26).

\textsuperscript{333} Message of President to House and Senate, 44 Cong. Rec. 3344 (June 16, 1909).

\textsuperscript{334} See supra text accompanying note 316.

be needed to open the records to the public. However, none of the $100,000 Congress appropriated to effect the tax could be used in the District of Columbia (due to statutory prohibitions). \(^{336}\) Therefore, Cabell stated, if "it was the intent of Congress to make these returns open to general inspection, it will be necessary for [Congress] to appropriate a sum sufficient to cover the necessary expenses." \(^{337}\) Until such time records would not be open to the public. A person other than the taxpayer making the return, desiring to view a return, was required to apply in writing to the Secretary of the Treasury, "who in his discretion [would], upon a proper showing of cause, approve such request." \(^{338}\) This pronouncement, for all practical purposes, abolished the publicity feature.

Meanwhile, several bills had been introduced to formally abolish either the publicity feature or the entire corporation excise tax. While these bills ended up in the purgatory of "referred to Committee," another attempt to amend the publicity feature was more successful. In 1910 the Senate added an amendment to the appropriation bill, H.R. 22643, amending the publicity feature of the corporation excise tax to read as follows:

> That the reports required by section 38 of said act shall only be made public when called for by resolution of the Senate or the House of Representatives or upon the order of the President when he deems it for the public interest, and that the Secretary of the Treasury shall formulate rules and regulations for classifying, indexing, and exhibiting said reports or any information therefrom; which said rules and regulations shall be approved by the President.\(^{339}\)

On April 1, 1910, the House discussed this amendment at length. Congressman Bartlett of Georgia immediately moved to return the bill to the Senate "with the request that the amendment be stricken from the bill, because it invades the constitutional privilege of the House to originate bills for the raising of revenue." \(^{340}\) After much discussion the resolution was rejected. \(^{341}\)

The separation of powers issue also appeared in connection with the proposed amendment. Some House members objected to giving the President, or any other administrative or executive officer, "the right to publish facts as against any particular corporation around election time." \(^{342}\) If

\(^{336}\) Id.
\(^{337}\) Id.
\(^{338}\) Id.
\(^{340}\) 45 Cong. Rec. 4128 (Apr. 1, 1910). The debate on this issue comprises several pages of the Congressional Record.
\(^{341}\) 45 Cong. Rec. 4134-35.
public disclosure were a discretionary power in the hands of the President, then political favors (past or present) could ensure privacy while political disfavor could threaten disclosure. For this reason some congressmen favored either absolute publicity or none at all.\footnote{343}

The potential abuse of the discretionary power to publicize for political purposes was not the only danger. Several members noted that if the discretion to publicize rested in the executive branch, Congress itself might be denied information as had already happened with the Bureau of Corporations under President Roosevelt.\footnote{344} Congress feared that although the current President was “benign . the time might come when we might have a malign President.”\footnote{345} To give the President such power of disclosure was dangerous.

The exact nature of the publicity feature also gave rise to much debate. Representative Sherley believed that the original language of paragraph six making returns “public records” did not mean that \textit{anyone} could go look at the records; rather, public returns open for inspection meant, he believed, merely the “common-rule” that the records “would be open to the inspection of those having the right to inspect them and not open to the public generally.”\footnote{346} Representative Smith of Iowa agreed that the records were not open to the public in general but were public records of the Treasury Department and at common law only those who had an interest in the subject matter of the records could inspect them.\footnote{347} Smith stated that no federal law overruled the common law; rather, the law provided for the Secretary to promulgate regulations for the use and retention of its records.\footnote{348} Congressman Fitzgerald of New York disagreed, stating that the intent of the original bill was to provide “complete publicity” of returns.\footnote{349} Many states, he asserted, already required similar information, a situation which he believed precluded objections to the publicity feature.\footnote{350} In addition, the word “publicity” was used loosely in political speeches, often more for rhetorical effect than actual effect, sometimes referring to the general public

\begin{footnotes}
\begin{enumerate}
\item E.g., 45 \textsc{Cong. Rec.} 4134 (statement of Rep. Bartlett).
\item 45 \textsc{Cong. Rec.} 4134 (statement of Rep. Bartlett); 45 \textsc{Cong. Rec.} 4140 (statement of Rep. Hitchcock).
\item 45 \textsc{Cong. Rec.} 4141 (statement of Rep. Harrison of New York).
\item 45 \textsc{Cong. Rec.} 4136.
\item 45 \textsc{Cong. Rec.} 4136; see also 2 W \textsc{Cook}, \textit{A Treatise on the Law of Corporations Having a Capital Stock} § 511, at 1387-88 (6th ed. 1908). At common law, one had a right to inspection when a property right or some controversy was involved “or some specific and valuable interest [was] in question.” \textit{Id.}
\item 45 \textsc{Cong. Rec.} 4136 (Rep. Smith citing § 161 of the revised statutes: “The head of each department is authorized to prescribe regulations not inconsistent with law for * * * the use and preservation of the records, papers, and property appertaining to it.”).\footnote{351}
\item 45 \textsc{Cong. Rec.} 4137.
\item 45 \textsc{Cong. Rec.} 4133. In fact, contrary to Fitzgerald’s statement, state requirements varied greatly as to what information was required and to whom it was available. \textit{See supra} note 56 and accompanying text.
\end{enumerate}
\end{footnotes}
and sometimes referring only to government access to information.\textsuperscript{351} It is no wonder that the House was confused as to the extent of publicity provided in the Act.

A few congressmen, however, had no doubts as to the true meaning of the original publicity clause in the corporation tax. Congressman Underwood, for example, stated that the House never had any intention of providing publicity as evidenced by its failure to include in the original appropriation for the tax an appropriation of money for use in Washington.\textsuperscript{352} Moreover, Underwood believed that publicity in tax returns was not needed to regulate the railroads because they already provided information to the Interstate Commerce Commission. On the other hand, publicity was needed to regulate "the great trust corporations of this country, but Congress, up to this time, has never said that it proposed to go into the business of regulating the trusts."\textsuperscript{353} In fact, he stated, since Congress expected the Supreme Court to disband the trusts under the Sherman Act,\textsuperscript{354} the only corporation left subject to the publicity provision was "the little domestic corporation in the State that is performing a local business and with which the Government of the United States should have nothing whatever to do."\textsuperscript{355} There was never an intent to enforce publicity, he said, because at the time of its passage the tax "was a subterfuge . . . the sole purpose for injecting this provision in the law was to side-track an income-tax law that was about to be passed in the United States Senate."\textsuperscript{356}

Underwood, in his rush to condemn the duplicity of those who favored the passage of the corporation tax instead of an income tax, overlooked the whole category of corporations which were not trusts but which engaged in interstate business. Other congressmen, however, seemed to accept publicity about some corporations, but not about small ones since the provisions of information about these small corporations "would only gratify the

\begin{itemize}
\item \textsuperscript{351} See supra notes 75-79 and accompanying text.
\item \textsuperscript{352} 45 Cong. Rec. 4131. Underwood referred to a statute that provided that "no appropriation for a specific purpose shall be used for the employment of a force in Washington in these departments unless it is specifically provided in that appropriation that it shall be used in the District of Columbia." Id., see also T.D. 1594, 13 Treas. Dec. Int. Rev. at 20. Representative Tawney disagreed, stating that the House believed money would be appropriated for the purpose of employing clerical staff in Washington to provide for publicity and was unaware of the failure to so appropriate funds. 45 Cong. Rec. 4132.
\item \textsuperscript{353} 45 Cong. Rec. 4131.
\item \textsuperscript{354} Presumably, Underwood was referring to United States v. American Tobacco Co., 221 U.S. 106 (1911), and Standard Oil Co. v. United States, 221 U.S. 1 (1911), cases then pending before the Court and decided in 1911. See supra note 29.
\item \textsuperscript{355} 45 Cong. Rec. 4131.
\item \textsuperscript{356} Id., see also 45 Cong. Rec. 4139 (statement of Rep. Hitchcock) ("I believe the corporation tax and the publicity provisions were merely devices used by President Taft's administration to escape from the inheritance tax, to which the administration was pledged, and also to defeat the income tax, which was popular, and a majority for which already existed in the two Houses of Congress at that time.").
\end{itemize}
curiosity or malice or ill will of others," or provide the big corporations with enough information to drive them out of business. Representative Sherley of Kentucky was against the publicity feature and against the corporation tax (he favored an income tax). Nevertheless, given the existence of the corporation tax, he favored a distinction between corporations which had "a relationship with the public" and those that did not. The small corporations, which had no such relationship, should not be subject to the publicity clause: "The thing that has made America great beyond all things else has been the freedom of the individual from undue governmental control. And as to certain corporations [i.e., small ones] involved herein, they are really the same as the individuals that compose them."

Thus, many congressmen differentiated between the large corporations which were public in some vague sense and small corporations which were really like partnerships, that is, simply aggregations of individuals. As Representative Tawney of Minnesota stated:

The public have an interest in knowing what the actual financial condition of certain classes of corporations is. Under this amendment the public will have the opportunity to examine and verify the statements of these corporations made to stock exchanges where their stock is listed for public sale. By comparing the same with their published statements, they can determine their truth; their actual financial condition will be known. As to corporations whose stock is not offered to the public for investment, an investigation of the returns may or may not be necessary for the benefit of the public, and as to all such corporations the matter of making their returns subject to inspection is left to the discretion of the President of the United States.

The House ended its debate on publicity by rejecting the Senate amendment and passing its own version which provided an appropriation of $25,000 for "classifying, indexing, exhibiting, and properly caring for the returns of all corporations required by section 38" and made all returns open to "inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President." The provision was enacted on June 17, 1910.

On November 25, 1910, pursuant to an executive order of President Taft, the Treasury Department issued regulations governing the publicity of

358. 45 Cong. Rec. 4136 (statement of Rep. Smith that he was aware of many small and moderately-sized corporations which feared being destroyed by large corporations); see also 45 Cong. Rec. 4139 (statement of Rep. Hitchcock that small corporations complained of the publicity feature).
360. Id.
362. 45 Cong. Rec. 4142, 4144.
returns. As a consequence of the rationale that publicity could help prevent stock watering and promoter schemes, the regulations created two classes of corporations, those whose stock was offered to the public and those whose stock was not. Since the latter stock was closely held there was no danger of promoter abuses deceiving the investing public. Consequently, the returns of closely held corporations were open to inspection only to proper employees of the Treasury Department. Other government employees could inspect them for proper cause on approval of the Secretary. State access to returns was upon approval of the Attorney General. Shareholders of a corporation might be permitted to inspect a corporation's return upon application to the Secretary "setting forth what constitutes a proper showing of cause." No definition or example of proper cause was given. The general common law rule was that a shareholder had a right of inspection "at any reasonable time, and for any reasonable purpose." Generally, shareholders could inspect when some property right, controversy or "some specific and valuable interest [was] in question." However, the right would not be granted "to satisfy curiosity, nor to aid the stock-market speculations of the stockholders." Many states had enacted statutes giving shareholders various rights to inspect books. Exactly what rights of inspection shareholders had under these statutes and what constituted proper cause were never made clear in the regulations nor in later Treasury announcements. This provision, then, was of limited help to shareholders, and of no help to non-shareholders.

In contrast to closely held corporations, more publicly held corporations presented situations of potential abuse of investors. The regulations, therefore, required publicity of the returns of these corporations in order to provide potential investors the information needed to make informed decisions. In this respect the regulations became the forerunner of Securities and Exchange Commission reporting. The key to whether a corporation's returns would be open to the inspection of any person was whether the corporation offered its stock for sale to the public. Paragraph three provided that:

365. Id. at 119.
366. 2 W Cook, supra note 347, § 511, at 1387-88. At common law, non-shareholders had no right to inspect corporate books, even if they were suing or being sued by the corporation. Again, some states had passed statutes providing for some publicity, but these varied from state to state and were of limited use to out-of-state persons interested in a particular corporation. Id. § 519, at 1409.
367. Id. § 511, at 1388.
368. Id. § 515, at 1394.
369. See, e.g., id. § 518, at 1404-07.
The returns of the following corporations shall be open to the inspection of any person upon written application to the Secretary of the Treasury:

(a) The returns of all companies whose stock is listed upon any duly organized and recognized stock exchange within the United States, for the purpose of having its shares dealt in by the public generally.

(b) All corporations whose stock is advertised in the press or offered to the public by the corporation itself for sale. In case of doubt as to whether any company falls within the classification above, the person desiring to see such return should make application, supported by advertisements, prospectus, or such other evidence as he may deem proper to establish the fact that the stock of such corporation is offered for general public sale.370

Although these regulations provided less than total publicity for all corporations, they were nevertheless a major achievement for proponents of corporate regulation. As Senator Root suggested, the government might want information on all corporations so as to get a complete picture of the business world. However, the general public did not need this information to protect themselves as potential investors.371 The regulations met both these needs, providing the government with access to information on all corporations, but limiting public access to information to corporations offered for sale to the public. Arguably, the public had the right to information about small corporations so as to ensure a fair, competitive price. Certainly, in some local markets, a closely held corporation did dominate the market enough to dictate prices. In general, however, the large corporations—not these small ones—set prices. Therefore, information on closely held corporations would generally not be helpful to the public. Consequently, a conservative administration such as Taft's, especially when it was beset by a deluge of complaints from small corporations, would not dictate publicity for these small corporations.

The regulations addressed the main perceived abuses—stock watering and abusive promoter schemes—in a manner in keeping with the Progressive Era: the provision of information by itself acted as a corrective to the problem. This is a conservative approach in that the government does not actively prevent the abuse by regulation or law; rather, it provides information which allows the private sector to do the regulating. According to the Commissioner of Internal Revenue, this modest method achieved results. In 1912 he reported that the tax was having a "most wholesome effect on the commercial world."372 First, in order to file returns, corporations had to keep accurate books and records, the accuracy of which was heightened

371. See supra note 275 and accompanying text.
by the Bureau of Internal Revenue checking up on the returns and by penalties for false and fraudulent returns. \(^{373}\) Secondly, these records and the fact that they were checked by the Bureau provided "powerful assistance in detecting and punishing the promoters of 'get-rich-quick' and other fraudulent and stock-jobbing concerns." \(^{374}\)

**Conclusion**

The Corporate Excise Tax was a result of the interaction of two major areas of change in the Progressive Era: taxation and the growth of large corporations. Income taxation rose from the ashes of constitutional defeat in 1895 to constitutional victory (an amendment) in 1913. In the same time period corporations grew and consolidated, achieving a restructuring of the marketplace. The traditional view of the Corporate Excise Tax, focusing on the tax's income component, holds that the tax was a political ploy to defeat the income tax in 1909. This view is incomplete because it ignores the second area of change: corporate growth. While Taft clearly wanted to forestall an income tax, the method of doing so did not need to include a tax on corporations.

Taft's predecessor, President Roosevelt, had announced a policy of strong federal regulation by the executive branch under which corporations engaged in interstate commerce would be federally incorporated (and possibly de-franchised for non-compliance). Such a policy raised troubling questions about federal-state relations and the growth of the federal government, particularly the executive branch. Taft's announced policy was also to regulate corporations. However, given his more conservative, pro-business stance, Taft's regulatory program was less activist. Taft's stance is evidenced by the fact that he eventually dropped his support of federal incorporation. Taft's choice of such a tax occurred because of the second area of change. Taft, reflecting the concerns of the time, had announced his intent to regulate corporations in order to curb their abuses.

Concern about corporations focused on the large corporations and their monopoly of the market. Related to this concern was a concern about protecting investors from overcapitalization and promoter schemes. The era strongly believed in the power of information. Publicity of abuse by itself could help eradicate the abuse. Moreover, access to information would help both the government and the public act to limit abuse. The government needed data to make effective, scientific laws in areas affecting corporations such as tariffs, currency, antitrust and interstate commerce. The public, provided with financial information on corporations, could make informed

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373. *Id.* at 17.
374. *Id.*
decisions about which companies to invest in and thus could foil promoter schemes. Information, or publicity, was critical to regulation; information, however, was scarce. Private financial services, though growing rapidly, were still in their infancy. Nor did the government have a regular source of information on corporations, except in specialized areas such as railroads.

Publicity was a well-recognized method of regulation and was widely advocated—though whether it was publicity to the government or to the general public was often unclear. The extent of regulation beyond publicity, how it should be accomplished and who should accomplish it were all highly debatable.

Taft's proposal and support of the Corporate Excise Tax reflected his desire to both regulate corporations and to halt the income tax. From the earliest days of his presidency, Taft considered some type of tax on corporations. His proposal to Congress in June, 1909, specifically mentioned the merits of the tax as an aid to supervising corporations. His specific support of the publicity provision, through which the supervision would be accomplished, during the debates on the law and after enactment, supports the position that Taft viewed the tax as part of a regulatory program. Despite this, the modern reader, like some of Taft's contemporaries, is not without justification in questioning Taft's sincerity in the matter. The initial publicity feature was not enforced and was, in fact, replaced the next year with a more limited provision. Furthermore, although Taft did propose a federal incorporation bill in 1910, he later withdrew his support for the idea.

Was the tax simply all rhetoric and no substance? I believe not. The tax can rightly be seen as a legitimate, though moderate, attempt to impose some regulation on corporations. Other regulatory methods such as federal incorporation were more controversial, raising issues of federal-state relations, increased federal power in general, or specifically, excessive executive power. The excise tax, in contrast, raised these same issues, but on a much smaller scale. It was, therefore, an appropriate regulatory mechanism for a conservative president. Taxing corporations for the privilege of doing business in corporate form, for example, was criticized as impinging on states' rights since states incorporated corporations and already taxed them. Compared to federal incorporation, however, these objections lacked strength. First, taxation was an established federal power, unlike incorporation. Second, the tax did not impact the corporation to the same extent as some federal incorporation proposals which gave the federal government the power to prevent corporations from engaging in interstate commerce.

The tax achieved its regulatory purposes through its reporting and publicity features. These features, even as amended by the 1910 Act, met basic supervisory goals. All corporations, no matter how small, had to file returns with the Internal Revenue Service. This requirement theoretically provided the government with the steady flow of data it needed to make informed
decisions in areas such as tariffs and trusts. Only returns of corporations listed on an exchange or offering their stock to the public were available to the general public. Since these were the very corporations which most threatened the investing public by means of overcapitalization (stock watering) and promoter schemes, the limited publicity feature addressed the major problem.

Perhaps, as Taft himself stated and others believed, publicity was merely the first step in his program; perhaps, given his subsequent inaction in the area, it is all he ever intended. Nevertheless, publicity was a well-respected form of regulation. Moreover, it was a preliminary step necessary for any further regulation. Being a mild form of regulation, it was particularly suited to a conservative president. Because publicity is such a mild form of supervision, people today may tend to dismiss its power. That would be a mistake given the era's faith in its efficacy. Nor is that faith outdated. It is this faith which led to the securities regulation acts of the 1930s and which still invigorates these laws.

Debate on the Corporate Excise Tax reflected the then current flux in corporate legal theory occasioned by the proliferation of corporations, and the growth of large, non-owner managed corporations. As corporations evolved from specially chartered creatures of the state with limited powers into entities with broad powers established under general incorporation laws, the theory of legal personality evolved from an artificial entity theory into a natural entity theory. Both sides on the tax debates drew support from the various theories of the firm, particularly the artificial entity and aggregate theories. The law taxed corporations as corporations per se, and differed in that respect from earlier taxes on businesses (no matter what form they were carried on in). Opponents of the tax used either aggregate or natural entity theories to criticize the tax as unfair; it was unjust to tax a corporation engaged in a certain activity if a partnership was not taxed because a corporation was merely an aggregate of individuals. Proponents of the tax stressed the corporation's artificiality in two ways. One approach, addressed to income tax advocates, stressed the artificial aspect of the corporation in order to emphasize that corporations were owned by individuals and these wealthy individuals really bore the tax. The other, more common approach focused on the legal entity aspect. Singling out corporations was permissible because only they had advantages created by the state. This rationale drew added strength from the form of the tax; it technically was not an income tax but was an excise tax on the privilege of doing business. Both strands reflected popular hostility to large corporations as centers of power and wealth.

While discussing the nature of corporate personality, Congress evidenced an awareness that small corporations by nature were different from large corporations. Small corporations were akin to partnerships, but large ones
were a different species. This awareness resulted in the law treating small corporations somewhat differently from large ones. Small corporations were exempt from paying taxes, but they did have to file returns. Corporations not listed on exchanges nor sold to the public were exempt from the publicity provision.

The corporate tax debates and the final form of the law not only reflected the times but also foreshadowed current problems and indeed still influence the tax laws. Present law continues to grapple with major issues faced in 1909. There is a continuing attempt to differentiate between large and small corporations. Interest and dividend treatment also remain problematic. Ironically, Congress is now experimenting with limitations on interest deductions to curb perceived corporate abuses in the takeover area just as the 1909 Congress imposed interest limitations to curb abuses in the stock issuance areas.

The most important reflection of the past upon the present is the continued existence of a separate corporate tax. This Article has shown how theories of corporate personality can influence the manner of taxation of corporations. In 1909 the artificial entity theory justified treating corporations separately from their owners and differently than individuals. Today corporate theory recognizes a mixture of entity and aggregate features, depending on the situation. Indeed, today's pet theory, the economic theory of the firm as a nexus of contracts between individuals, tends to eliminate the corporation as an entity. This theory supports full integration of corporate and individual taxes since it sees the corporation as a mere conduit rather than as a separate entity.

Economic theory's drive toward integration, however, encounters the Corporate Excise Tax of 1909 as a roadblock. At a practical level, the roadblock consists of resistance to integration shaped by eighty years of precedent dating back to 1909. At a theoretical level, the history of the tax exemplifies and reminds one of the intertwining of corporate theory and taxation. So long as various conceptions of the corporation exist, as they do today, economic theory's justification of integration is a claim of theology, not of truth.

376. The American Law Institute did not advocate integration in its 1982 Federal Income Tax Project on Subchapter C allegedly because of Stanley S. Surrey's opposition. In Surrey's view, the theoretical justification for integration—the conduit theory of the corporation—was simply a matter of "tax theology." Sheppard, Corporate Tax Integration, The Proper Way to Eliminate the Corporate Tax, 27 TAX NOTEs 637, 640 n.6 (1985). I would expand that to say it is a claim of corporate theology also.

Economics might claim that regardless of the theoretical conception of corporations, the truth is that the actual incidence of the tax ignores the corporation. Given the difficulty of determining who bears the burden of the tax, the response might be that theories of personality must ultimately influence the shape of the tax.