"Can Business Pay Taxes?"

by Milton Friedman

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President Nixon's proposals for reductions in taxes have been widely criticized as a "help-the-rich" program "heavily weighted in favor of business at the expense of the individual taxpayer."

This criticism is sheer demagoguery. The elementary fact is that "business" does not and cannot pay taxes. Only people can pay taxes. Corporate officials may sign the check, but the money that they forward to Internal Revenue comes from the corporation's employees, customers or stockholders. A corporation is a pure intermediary through which its employees, customers and stockholders cooperate for their mutual benefit. A corporation may be large and control large amounts of capital. Yet it does not follow that a reduction in the check it sends to Internal Revenue benefits wealthy individuals.

Consider, for example, the proposed repeal of the exercise tax on automobiles. At first glance, the main beneficiaries are the upper-income people who buy the new cars. But this is too simple. Many cars are purchased for business purposes, and the beneficiaries are the customers, employees, proprietors and stockholders of the firms buying the cars. More important, increased production of cars will lower prices of secondhand cars, benefiting their purchasers, who are mostly in lower-income classes. The greater sales of new cars will also benefit employers, proprietors and stockholders of firms producing and selling cars. However, it will harm employees, proprietors and stockholders of firms producing items for which the demand is now lower because spending has been diverted to new cars.

Or consider the proposed investment-tax credit. Surely, you will say, that benefits corporate stockholders, and we know that they are generally wealthy. True, but misleading. The firms that qualify for the credit will have an incentive to expand. But this adds to the demand for loans, which will tend to raise interest rates, spreading some of the benefits to savers and imposing costs on other users of capital. It will also add to the supply of goods that the firms getting the credit produce, benefiting their customers by lowering prices and their employees by providing better employment opportunities. Stockholders or proprietors of these companies will of course also benefit, but stockholders, proprietors, customers and employees of firms that do not qualify for the credit will be hurt.

And even this is only part of the story. The rest depends on how the government replaces the revenue, whether by imposing taxes, by borrowing or by reducing spending, and who is thereby benefited or harmed.

Indirect effects make it difficult to know who "really" pays any tax. But this difficulty is greatest for taxes levied on business. *That fact is at one and the same time the chief political appeal of the corporation income tax, and its chief political defect.* The politician can levy taxes, as it appears, on no one, yet obtain revenue. The result is political irresponsibility. Levying most taxes directly on individuals would make it far clearer who pays for government programs.

Under our present tax system, stockholders pay no individual income tax on income that a corporation earns but does not pay out as dividends. Reinvestment of such undistributed income tends to raise the value of the corporation's stock. When and if the stockholder sells his stock, he receives the benefit in the form of a capital gain that is taxed at lower rates than his current dividends. The corporation income tax is defended as a way to prevent such undistributed income from being undertaxed.

A far better way to achieve this objective is to require corporations to attribute undistributed income to their stockholders and to require stockholders to include the undistributed income in their individual income. That is, the XYZ corporation would accompany its dividend check to stockholders with a notice, saying, "In addition to the $1 per share we are now paying you as dividends, we have earned $1.25 per share that we are reinvesting on your behalf." The stockholder would then report $2.25 per share as his income from the stock and pay individual income tax on that amount (and raise his capital gains base by $1.25 per share).

This reform would promote both equity and also greater competition in the capital market. Until it is enacted, and the corporation income tax as such is repealed, the demagogues will continue to have a field day.

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